The Journal of Social, Political and Economic Studies

Spring, 1996 Vol. 21, No. 1

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The Journal of Social, Political and Economic Studies is published quarterly by the Council for Social and Economic Studies. All correspondence should be addressed to The Editor, P.O. Box 34070, N.W. Washington D.C., 20043, U.S.A. [Telephone (202) 371-2700: Fax (202) 371-1523]. Formerly known as *The Journal of Social and Political Affairs*, the subscription rate is $80.00 per annum for libraries and institutions, although scholars and private individuals are entitled to a privileged rate of $37.50 per annum. Reduced three-year subscriptions are available at a cost of $210.00 for libraries and $90.00 for individuals. For mailing addresses outside the USA please add $5.00 per annum. The attention of readers is also drawn to the valuable Monograph Series (ISSN 0895-724X) published in association with the Journal and advertised elsewhere in this issue. Members of the academic community and other qualified individuals are invited to consult the General Editor at the above address concerning articles which they may wish to submit for possible publication.

ISSN 0193-5941

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The Journal of SOCIAL, POLITICAL AND ECONOMIC STUDIES

Roger Pearson
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Spring, 1996 **Vol. 21, No. 1**

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Toward a New Quality: The Russian Military Doctrine and Eurasian Security

Spencer D. Bakich
James Madison University

Russian military actions since 1991 have brought debate and speculation to the international community regarding Russian designs toward the "near abroad," the states which formerly constituted the Soviet Union. Operations in Moldova, Georgia, Tajikistan, and even on the territory of the Russian Federation in Chechnya have proceeded with many observers failing to come to terms with the "broad picture." Largely, the question of Russia's intent in these theaters has been ignored or handled in a cursory manner. This paper is an attempt to provide the conceptual framework for interpreting such events. Currently, there exists few means at the disposal of scholars to determine exactly what Russian military philosophy is and how that philosophy relates to foreign policy in general. Perhaps the best tool to date for this purpose is the Military Doctrine of the Russian Federation.

Environmental Influences on the Drafting of the Military Doctrine of 1993

Since its conception, the Russian Federation (RF) has had to cope with a number of political realities. These realities, whether understood immediately, or through trial and error, are foundational in the RF's quest for nationhood. One of the most pressing elements in all of Eurasia is the necessity to achieve international security. With the dissolution of the Soviet Union, the space that was once the whole of the monolith has been inherited by new states with new archetypal problems in terms of security.

In addressing this and many other defense related issues, the RF drafted its first military doctrine early in 1992. This doctrine was dually influenced by the Russian Liberals and "hawks" within governmental circles. This draft doctrine ultimately failed to meet the political and military expectations of many within Russia. Finally, with the firing upon the parliament building in October of 1993 by

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the armed forces, the President was able to achieve many political goals which were stalled by intra-governmental battles prior. One of these battles won by the President was over the content of the military doctrine.

The current military doctrine of the Russian Federation is essentially a political statement establishing the mission of the Russian armed forces in the post-Soviet world in which NATO and the United States' nuclear arsenal no longer poses a major threat to Russia, and in which the armed forces no longer support "progressive" revolutions in distant countries. According to the doctrine, approved by the Security Council on November 2, 1993, "Though the threat of world war has not been eliminated yet, it has considerably reduced by now. The main current source of danger is local wars and regional conflict. This danger is constantly growing."[1]

This new doctrine, while similar to its predecessor in a number of ways, did differ substantially. Initially, the new document went further in abandoning the Cold War influence regarding potential adversaries and thinking in terms of a possible major conventional war. Secondly, the doctrine gave greater attention to possible local wars and the need to prepare for them. These new interpretations regarding threat assessment had a radical impact on the general posture of the armed forces. Military strategists now assert, with some level of credence, that the armed forces in Russia and the CIS should not be seen as a threat to anyone, while at the same time they should be sufficient to rebuff any type of aggressor. According to Ruslan Khasbulatov, the future of Russian and CIS armed forces will be defined first by the situation on the home front and second by the new international environment which, in the last few years, has "significantly improved." These two influences have created a radically new political base for the military doctrine of Russia and for the military-political concept of the CIS Joint Armed Forces.[2]

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[1]Schmemann, Serge, "Moscow Outlines 'Doctrine' for its Future," *The New York Times*, 3 November 1993, A11.

[2]Garthoff, Raymond L., "Russian Military Doctrine and Deployments," *The International Politics of Eurasia. State Building and Military Power in Russia and the New States of Eurasia*, vol. 5 (New York: M. E. Sharpe, 1995), 57; and Khasbulatov, Ruslan, "The Commonwealth of Independent States: Conflicts, Problems, Perspectives," *Russian Security After the Cold War: Seven Views From Moscow*, ed. Johnson Teresa Pelton and

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With the adoption of the new military doctrine, a policy of radical transformation of the armed forces has been undertaken, the goal of which is to advance them to a new level of quality. At the heart of this policy is a combination of the defensive interests of the independent states with the shared interests of the Commonwealth, while at the same time preserving the maximum material and operational basis of a unified military-strategic space, ensuring the implementation of all commitments to provide world security, arms reduction and disarmament, and to provide true legal and socioeconomic protection of servicemen and their families. Any transformation of the armed forces is possible only within context and upon the basis of socioeconomic and political reforms in the society and with an appropriate change in the international situation. In short, the revolution which is taking place in the Russian armed forces does not exist in a vacuum. Rather, there are a number of specific factors which have and will continue to have an impact on the evolution of the military. These influential agents were all present during the drafting of the military doctrine. The document which now exists is a reflection of those pressures.[3]

This is not, however, a completed doctrine, rather one in a continuing process of elaboration. Kortunov notes,

> "Military doctrine and military-technical policy can be considered in their own way, the quintessence of military consciousness. It is not surprising therefore, that in a country where national consciousness is being formed, there is neither a clear military doctrine nor clear foreign policy priorities, nor a clear concept of national security."

At the same time, however, Russia cannot live without clearly formulated priorities in national security matters based on national interests. Without these, no serious discussion with allies can take place, nor can there be a well-thought policy in relation to potential

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Steven E. Miller (Washington: Brasseys 1994), 183.

[3]Shaposhnikov, Evgeni, "The Armed Forces: To a New Quality," *Russian Security After the Cold War: Seven Views From Moscow*, ed. Johnson, Teresa Pelton and Steven E. Miller (Washington: Brasseys, 1994) 186-87.

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adversaries.[4]

Thus, a military doctrine had to be formulated. The product was the result of two key elements at play within Russia and the world: the end of the Cold War and the "democratic revolution in Russia." Both factors have influenced international security and stability in the post-Cold War era in different ways. Thus, both influenced the formulation of Russia's military doctrine. Understanding these two factors, and their attached baggage, is key to coming to grips with Russia's military doctrine.[5]

The end of the Cold War meant that Russia had departed the relatively stable world in which it had once existed. This departure ushered in an era of instability, particularly in the Eurasian region. Armed conflict and local wars, an increasing threat of proliferation of weapons of mass destruction and missile delivery means, as well as conventional weapons, are now prevalent. As a result, military force remains a ponderable device in political arguments between states, primarily those on the periphery of Europe. Despite the illogic of maintaining the old Cold War infrastructure, the material basis--weapons and their production base-- remains. This infrastructure strives for self-reproduction, leading to a tremendous supply of arms for the international market.[6]

International factors further influenced the military doctrine and military-technical policy of the Russian Federation. The result was a redefinition of the general defensive character. Mobile fire groupings, first strike echelons, tank concentrations, etc., have disappeared from the structures of the armed forces. Now, the employment of air mobility, nuclear deterrence on an operational-tactical level, a transition to a corps and brigade structure, an orientation toward resolving tasks tied to peacekeeping operations, a transition to a professional army, an emphasis on military-technical policy supported by a highly advanced technology, the development

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[4]Kortunov, Sergei, "International and Domestic Political Factors in the Formulation of Military Doctrine and Military -Technical Policy in Russia," *Comparative Strategy* vol. 13 (UK: Taylor and Francis 1994), 43-44.

[5]*Ibid.*, 44.

[6]*Ibid.*, 45.

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of high precision weapons, the development of space systems (in particular, for air-, space-, and ground-operations), and a relative decrease in the role of heavy weapons has become the overriding orientation of the armed forces.[7]

Domestic factors also played an integral role in determining the content of the Russian military doctrine. Initially, Russia is undergoing a crisis of statehood. With the absence of concrete borders, there can be neither a national interest nor a concept of national security. Second, until now there has been no clear characteristic of relations among the CIS countries. Those nations which were once a part of the concept of "Russia" are now foreign. Without the formulation of such ties and relations, defining national security will be impossible. Finally, it is important to note that the firing on the parliament building in October of 1993 brought an end to the competition between the legislative and executive branches over the content of the military doctrine. Yeltsin's decision to use force to end this political stalemate, by default, assured the President the power to dictate the terms of the military doctrine.[8]

While the magnitude of the changes in military-political policy is undisputed, the normative assessment of those changes is highly contestable. There are many who view the adoption of the new doctrine as a stepping stone to neo-imperialist designs toward the "near abroad." For them, the doctrine is the result of a long and arduous battle fought over ideology by the "moderates" and the "hawks" outside the walls of the General Staff. Based on Grachev's assessment that the doctrine's authors worked under the assumption that as of now, "Russia has no probable adversaries," it is tenable to assert that the advocates of a strong military presence in the "near abroad" have achieved a high and influential position in foreign and military policy circles. While the text of the military doctrine does not contain such obligations, the document does contain references to the possibility of "exporting" military force. According to Lt. General (retired) Dmitriy Yevisyenko, such formulations in army language (as issued by Grachev) often cover up a readiness for full-scale aggression. The final variant of the doctrine testifies to a victory for

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[7]*Ibid.*, 45-46.

[8]*Ibid.*, 47.

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the "hawks."[9]

Politically, the new doctrine is indicative of a Russian military shift to the right, in line with the neo-imperialist moods of some in foreign policy circles. Moreover, the doctrine is a reflection of the continuing curtailment of domestic reforms in the country and of the growing influence of the top brass and further weakening of political control over the military. As asserted by those viewing the document as neo-imperialistic, the new doctrine envisions a return to the traditional pre-Gorbachev Soviet Army, albeit smaller in size and relying on a weaker economic foundation. Such a weakness and the consequent wounded pride of the military could be an additional explanation for the aggressive nature in the Russian General Staff and military in general. Finally, the military doctrine is not a testament to democratic reform in the army. On the contrary, the doctrine provides for the possibility to establish military bases on the territory of other states, to involve the Russian armed forces in other states' wars, and to intervene into other states' affairs.[10]

Grachev and Kozyrev in Defense of the Military Doctrine of the RF

Popular conception, both within and outside Russia, of the new Russian military doctrine was an integral component of legitimizing both the Russian military and the Russian Federation. If Grachev was correct in stating that the military doctrine is a "military constitution," it was of primary importance that the draft doctrine was accepted by the military and people of the RF. Without popular support, the government would have a difficult, if not impossible time, justifying present military actions and holding the military subordinate to it. It thus fell to Grachev and Kozyrev to act as representatives of the new doctrine of military philosophy and policy.

General Grachev begins his defense of the doctrine by

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[9] "Experts See Hawk's Win on Military Doctrine," FBIS-SOV-93-221, 18 November 1993.

[10] Arbatov, Alexei G., "Russian Foreign Policy Priorities for the 1990s," *Russian Security After the Cold War: Seven Views from Moscow*, ed. Johnson, Teresa Pelton and Steven E. Miller (Washington: Brasseys, 1994), 38; and "Military Doctrine Seen Increasing Army's Clout," FBIS-SOV-93-226, 26 November 1993, 44-45.

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describing the high level of tension in the individual regions near Russia. The probability of local and regional conflict within the individual states on the basis of national-ethnic, territorial, religious, and other contradictions continue to exist. Of particular danger to regional and international stability is the continuing growth of aggressive nationalism in various regions of the world, particularly in Eurasia. With these new threats in mind, Grachev claims, the military doctrine of the Russian Federation was formed.[11]

According to Grachev,

> For the first time, Russia states that we protect not ideology but the vitally important interests of the country, which do not affect the security of other states in any way and are ensured within the framework of mutually advantageous interstate relations based on equal rights.

Key to this claim is that Russia does not see one state or bloc as its enemy. As a result, a radical review of approaches to the entire spectrum of problems of military-organizational development has begun.

> The doctrine represents a system of views, officially adopted in the state on wars, armed conflicts, their prevention, military-organizational development, the preparation of the country for defense, the building and training of the armed forces and other troops, and the procedure and methods for using them to protect the vitally important interests of the Russian Federation.[12]

The military doctrine is an official normative-legal document, a constituent component of the Concept of Russian Federal Security, and represents a "document of the transition period – the period of the formation of Russian statehood, the implementation of democratic reforms, and the formation of a new system of international relations." This document, asserts Grachev, is not

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[11]"Grachev Gives Overview of Military Doctrine," FBIS-SOV-94-112, 10 January 1994, 20.

[12]*Ibid.*, 21.

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dogma, but a doctrine open to relevant revision as the military-political situation develops.[13]

On the political principles of the military doctrine, Grachev claims there are two interconnected tasks: (i) the prevention of war and (ii) readiness to repulse an aggressor. Russia rejects any war, uses of military force, or threat of force as a means of achieving political, economic, and other aims. Rather, the RF now advocates, through the doctrine, the adoption of commitments by all states not to use military force first and adhere to the principles of inviolability of state borders and non-interference in the internal affairs of other states. Further, all questions under consideration should be resolved by political and diplomatic means.[14]

Countries of the "unpublicized nuclear club" – those ten countries on the threshold of producing nuclear weapons – form a fairly dense half-circle, embracing from the south, the geo-strategic space occupied by Russia and its closest neighbors. The result is the creation of a vague zone of nuclear risk. Therefore, Russia has an obligation to adopt a policy of nuclear deterrence which fully meets these circumstances. This policy imperative is echoed in the doctrine,

> The aim of the Russian Federation in the sphere of nuclear weapons is to eliminate the danger of a nuclear war by deterrence against the unleashing of aggression against the Russian Federation and allies.
>
> Russia, does not see nuclear weapons as a means of conducting military acts, rather as a means of deterrence against such aggression.[15]

One of the most notable omissions in the military doctrine is that of the non-first-strike of nuclear weapons pledge. According to Grachev, Russia has not resolved to confirm this commitment, as the Soviet Union did, because this would contradict the task of

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[13]Ibid., 21.

[14]Ibid., 21.

[15]Ibid., 22.

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deterrence. This is not a switch to a concept of the preemptive use of nuclear weapons, rather a demonstration of resolve to avert the unleashing of a large scale war against the Russian Federation and its allies. According to the doctrine,

> The Russian Federation will not use its armed forces and other troops against any state except for individual or collective self-defense if an armed attack is carried out against the Russian Federation, its citizens, territory, armed forces or other troops, or its allies.

It is for this reason, Grachev claims, that there can be no consideration of a preemptive strike of nuclear weapons, since the strategic nuclear forces are a constituent component of the armed forces. From the political view point, the principle of the use of nuclear weapons, expounded in the doctrine, places Russia on an equal footing with other nuclear countries and will serve as an incentive for further reductions and nonproliferation of nuclear weapons.[16]

On the existence and use of the military, Grachev asserts that the Russian Federation deems it necessary to possess armed forces and further deems it lawful to use them for the protection of the RF's sovereignty, territorial integrity, and other vitally important interests in the event aggression be committed against it or its allies. In the present conditions, political efforts can be effective in ceasing such aggression only if they are supported by military might which is sufficient for the defense of Russia.[17]

On the military principles of the doctrine, General Grachev notes that the basic spheres and principles of ensuring the Russian Federation's military security are determined by: (i) the development of a system of bilateral and multilateral agreements and Russian membership in collective security structures or the establishment of cooperative relations with such structures; (ii) the improvement of existing international mechanisms for monitoring the proliferation of weapons of mass destruction and delivery vehicles and the creation

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[16]Ibid., 22.

[17]Ibid., 23.

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of effective new mechanisms; (iii) the creation of conditions for permanent action of the Nonproliferation Treaty (NPT) and also the adoption of measures to expand the number of participants in the treaty; and (iv) the expansion of confidence building measures in the military sphere including the exchange of information of a military nature on a mutual basis and the coordination of military doctrine and plans for military organizational development with Russia's allies and partners.[18]

Regarding the Conventional Forces in Europe Treaty (CFE), signed on 19 November 1990, General Grachev claims that the CFE was formed in an environment of inflexible confrontation between two systems. The result was the creation of regional partition and flank restriction on weapons and hardware which were necessary and specific to that era. The central theme of the CFE was geared to decrease the danger of concentration of weapons along the line of contact between the Warsaw Pact and NATO groupings. Now, however, the terms of the treaty dealing with flank restrictions have not only lost their political and military significance, but have in fact taken a discriminative character with respect to Russia. Indeed, the terms of the treaty are antithetical to Russian security interest along its southern borders. Instability in the Caucasus and neighboring regions and the growth of separatism and extremism necessitates a significant Russian military presence in the North Caucus region in order to prevent and deter potential conflicts and insure against the destabilizing forces in the region as a whole.[19]

Russia believes the main principles for resolving its military security problems are the maintenance of stability in regions adjoining its borders and compliance with international commitments. At the same time, the doctrine indicates that Russian security should be protected without prejudice to other countries' security or the security system as a whole. Russia is now formulating a blueprint for collective security within the CIS framework. The basis for this is the Collective Security (Tashkent) treaty. It is becoming evident that no state in the CIS can develop normally in various spheres without close integration. Grachev asserts that this is an objective assessment of

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[18]Ibid., 23.

[19]Ibid., 23.

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present realities, not the "hand of Moscow" or "imperialist thinking."[20]

The likelihood of a nuclear war or a conventional world war breaking out has significantly decreased, but the possibility of armed conflict and local or regional wars flaring up not only remains, but is increasing. Under certain circumstances, such conflicts could escalate into a large-scale (world) war. The military doctrine defines as the main objective of the use of the RF's armed forces as the ceasing of hostilities at the earliest possible stage. Ending conflicts quickly will enable the RF to create the prerequisites for settling such conflicts by peaceful means in line with Russia's interests. Of particular concern to Russia is the continuing possibility that wars waged merely with conventional weapons will escalate into wars where nuclear weapons might be used. Factors which could exacerbate this are predetermined by an aggressor who has as its design to destroy or disrupt the functioning of the strategic nuclear forces and/or conduct a missile attack on early warning radar systems, nuclear power industry installations, and/or nuclear and chemical facilities. Apart from the strategic significance, the destruction of such targets could have irreparable environmental consequences.[21]

Grachev includes peacekeeping operations as part of the new tasks for the military, if such operations are in line with the UN Security Council and other collective security organizations, or other international commitments if these do not contradict the interests of the Russian Federation. The main objective of Russian peacekeeping activities is to protect Russia's national security interests through encouraging the establishment and maintenance of peace and stability both on the planet and as a whole in various regions. Russia firmly adheres to the generally accepted norms and principles of international law as well as the specific norms and rules for carrying out peacekeeping activities: matching the form and content of peacekeeping steps to the situation to be resolved, giving priority to political over military ways and means of settling a situation, strictly observing and protecting human rights, and using military contingents of peacemaking forces only with the consent of the opposing side with

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[20]Ibid., 23-24.

[21]Ibid., 24.

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the approval of the international community. The leading areas of peacekeeping activities for the RF are: mediating in settling crisis situations and preventing the escalation of conflicts, influencing sides via diplomatic means first and in extraordinary cases by military means with a view to ensuring the fair and peaceful resolution of issues, and taking measures to preserve peace by disengaging conflicting sides by using military contingents of the armed forces of the RF operating under UN auspices or within the framework of the Collective Security treaty. According to Grachev, it is thus possible to maintain that there is nothing in the Russian peacemaking activities or in the tasks entrusted to its armed forces that runs counter to the fundamental, universally recognized norms and principles of international relations.[22]

The final issue discussed by Grachev is the stationing of Russian troops on the territory of the former Soviet Union which is indicated to be a possibility by the doctrine. According to the Defense Minister, concern over the "near abroad" is unfounded because the military doctrine states that "the conditions for such stationing and maintaining are defined in the appropriate international legal documents." These questions are in full accordance with the universally recognized norms of international law. Such a need is dictated by the interests of maintaining stability in individual regions. Their deployment is initiated primarily by those states that are in need of additional stabilizing factors. The need for military installations outside Russia's territory is determined by their purpose (i.e., missile attack early warning systems and radar stations) and in other cases by their technical uniqueness and by the impossibility of creating a replacement of equal worth on Russian territory in the very short term. In all cases, military bases are deployed outside Russia by mutual agreement among all sides.[23]

By way of conclusion, Grachev echoes the doctrine by claiming,

> The chief aim in building the Russian Federation armed forces is to create and develop troops (forces) capable of ensuring the defense of the country's independence, sovereignty and territorial

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[22]Ibid., 24-25.

[23]Ibid., 25.

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> integrity, the security of its citizens, and other vital interests of the society and the state in keeping with the military-political and strategic situation in the world and with the Russian Federation's actual potential.[24]

Former Foreign Minister Andrei Kozyrev is less detailed in his defense of the military doctrine, however his remarks are noteworthy, particularly those concerning the close relationship between the RF's military doctrine and foreign policy doctrine,

> Another guarantee of the stability and consistency of the country's foreign and military policy is the Russian Federation's military doctrine approved by the Russian President early in November. Together with the Foreign Policy Concept ratified in April, it is an integral part of the emergent concept for the country's security.[25]

Kozyrev's assessment of the doctrine, that being on par with the Concept of Foreign Policy, is important for two reasons. Initially, the Foreign Minister hotly contested the development of the Concept. To him, the Concept was a constraint imposed by parliamentarians who disagreed with his global vision and who favored a nationalistic/neo-imperialistic approach to Russian foreign policy. Secondly, after the draft Concept was ratified, it was hailed as a normative-legal document of the realist tradition in the West. Such documents and concepts have been said to be wholly foreign to Russia until now. Thus, Grachev's insistence that the doctrine is such, coupled with Kozyrev's comparison to the Concept, gives the military doctrine an immediate place of prominence; a pedestal on which it was hoped to be acceptable to the West and which places Russia's right to secure its "vital interests" in the "near abroad."

Beyond this comparison, Kozyrev's defense of the military doctrine does not differ from Grachev's. Kozyrev claims that the doctrine is "an obstacle in the way of any attempts to abuse military force . . . " at the same time allowing for Russia to "safeguard its

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[24]Ibid., 25.

[25]"Kozyrev Writes on Military Doctrine," FBIS-SOV-94-010, 14 January 1994, 52.

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security." Regarding Russia's nuclear forces, Kozyrev claims that the strategic forces are first and foremost a deterrent force. Specifically, Kozyrev states,

> It would be a mistake to make out that our new approach to nuclear weapons [the abandoning of the non-first-use pledge] increases the risk of nuclear war. The fact that we do not intend to be the first to use any weapons, and see nuclear weapons as a last resort, is of fundamental importance.

Finally, Kozyrev states that Russian peacekeeping forces are not fulfilling "some sort of gendarme function" rather a "mission fully consonant with its status and duties as a permanent member of the UN Security Council."[26]

In their assessment of the military doctrine, both Grachev and Kozyrev had to consider the numerous agents which have a direct impact upon the functioning of the armed forces of the Russian Federation. Initially, and most important, the criticism of the "hawks" in the General Staff, foreign and military policy circles, and the newly created Duma, had to be quelled not only for the sake of creating a viable policy set forth and conducted by the executive branch, but also for the sake of the two ministers' political lives. Thus, the tone of their defense necessarily took an archetypal pro-Russian resonance. The international community had to be satisfied as well. The insistence that the doctrine was a "normative-legal document" on the level of the Concept of Foreign Policy was an attempt to foster such acceptance. Further, the West had to condone the possible interference of Russian forces in the "near abroad." Thus, the doctrine contains, at numerous times, the phrase "vitally important interest of the Russian Federation." This ambiguous terminology was hoped to mollify international criticism while providing Russia the "legal framework" to protect its sphere of influence. As time has shown, this ambiguity has not stymied criticism, while providing the foundation for many military adventures which have proven to be disastrous.

Risks and Threats Defined

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[26]Ibid., 52-53.

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As previously mentioned, the end of the Cold War has ushered into the Eurasian region a host of threats to the security of the Russian Federation which have been largely absent for the past seven decades. Moreover, the legacy of the Soviet Union has fostered a number of highly volatile situations which Russia must confront. Large peacetime armies and the high mobility potential of some states; national ethnic, religious, and ideological conflicts; hegemonic ambitions of some states; and the potential change of leadership or a political and/or economic crises in some states are all identified by the doctrine to be a source of military instability. Further, the danger of an outbreak of war has been attributed to "social, political, territorial, religious, national-ethnic, and other conflicts and the desire of a number of states to want to resolve them by means of armed conflict."[27]

Among "the basic existing and potential sources of external military danger for the Russian Federation" depicted were territorial claims on Russia or its allies; spillovers from "existing or potential local wars and armed conflict, particularly those in the immediate vicinity of the Russian border"; nuclear proliferation; and several other categories. These categories have been points of concern in establishing a Russian foreign policy, in general: (i) instability and complexity of the political and economic situation in the RF, particularly the rise of separatism in regions within the RF and, (ii) continuous disagreements with the Baltic states, Ukraine, Kazakhstan, Georgia, Chechenya, and many other states and regions on economic, military, political, and ethnic issues and the possibility of emerging territorial disputes between Russia and the FSU that may pose a serious threat to Russian integrity and regional stability in general.[28]

Of the more contentious "external" sources of military danger

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[27] Rogov, Sergei, "Military Interests and the Interests of the Military," *Rethinking Russia's National Interests*, ed. Stephen Sestanovich (Washington: Center for Strategic and International Studies, 1994), 69; and Garthoff, Raymond L., 57; For additional analysis see FitzGerald, Mary C., "Russian Military Doctrine: Program for the 1990's and Beyond," 1993.

[28] Garthoff, Raymond L., 57 and; Shakleina, Tatiana, "Russian Policy Toward Military Conflicts in the FSU," *The International Politics of Eurasia. State Building and Military Power in Russia and the New States of Eurasia*, Bruce Parrott, ed. (New York: M. E. Sharpe, 1995), 85-86.

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described by the doctrine is "the suppression of the rights, freedoms, and legitimate interests of citizens of the Russian Federation in foreign states." This issue was one of the major sources of tension between the Russian Liberals, who were influential early on in the RF's existence, and those who advocated the resurrecting of Russia's great power status in nationalistic and neo-imperialistic terminology. The rights of Russian citizens abroad has only recently been supplanted by the "threat"of NATO expansion, as defined by the doctrine as "expansion of military blocs or alliances to the detriment of the interests of the military security of the Russian Federation." The mention of the interests of the Russian diaspora in the military doctrine represents the popular view of Russian compatriots abroad. By not categorizing this group as "Russian speakers," however, the potential scope of application has been decreased along with the concerns of the newly independent states. Moreover, the doctrine did not justify military intervention for the mistreatment of the diaspora, rather listing this concern as an "external threat."[29] In sum, what was once a highly volatile issue (as seen by Kozyrev's statements regarding the possibility of Russian military intervention on behalf of these individuals) has now been reduced in significance, a possible recognition by the Russian government that "saber-rattling" in the current political environment could lead to disastrous local conflicts and a tremendous over-extension of Russia's already strained and weakened military.

Five other situations identified as possibly creating "a military danger into an immediate threat" were detailed in the doctrine. Initially, the buildup of (indigenous) military forces on Russia's borders that could disrupt the prevailing correlation of forces was noted to be of primary importance. This is a specific reference to the possibility of a military threat coming from the southern regions of the FSU which might lead to the entanglement of Russia in local and regional conflict. Further, the introduction of foreign troops into the territory of neighboring countries, the training of armed groups in other countries for the introduction into the territory of Russia or its allies, attacks on the border installations of the RF and its allies to create border conflict or provocations, and actions taken to interfere

[29]Garthoff, Raymond L., 57 and; Shakleina, Tatiana, 86.

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with the functioning of Russian systems for the support of its strategic nuclear forces and of state and military command and control, above all the space component, were all identified as direct military threats to the security of the Russian Federation.[30]

To a New Quality: The New Russian Military Philosophy

The new military doctrine of the Russian Federation brought to the fore a host of new concepts in the political, military, and military-technical policy of the RF. Although these policies were radical departures from the previous doctrines of the Soviet Union and the RF, they were not without a foundation. The concepts introduced in the doctrine are a direct response to both local and geopolitical circumstances. It should be noted that the revolution taking place on all levels of military thought is by necessity, a reactive alteration rather than a Russian vanguard into a new era of strategic and military thinking.

Politically, the doctrine states that Russia's aim is to prevent war and maintain a constant readiness to repel aggression. Further, the RF will abide by all existing international treaties on defense issues, including those dealing with nuclear weapons and nonproliferation.[31] Taken at face value, this declaration tells nothing of the magnitude of the renovation of military preparedness Russia faces.

As FitzGerald notes, a review of Russian military writing reveals strong continuities with the predecessors of the military doctrine as the following: (i) a reevaluation of the nuclear non-first-use pledge, (ii) a redefinition of the defensive doctrine that encompasses only the socio-political aspects of military thought (not the military-technical side of the doctrine, i.e., Russia has no intention of attacking anyone), and (iii) a call for a new military art and tactics based on the "long distance" (remote) warfare exemplified in the Gulf War. Specifically, six changes in the principles of military art have been generated by "Desert Storm":

- A shift in concentration to mobility of forces

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[30]Garthoff, Raymond L, 58 and Shakleina, Tatiana, 86.

[31]Mackintosh, Malcolm, "Reform in the Russian Armed Forces," *Jane's Intelligence Review*, vol.6, no. 12 (UK: Jane's Information Group Limited, 1994), 536.

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- A shift from massing troops to the massing of advanced cruise missile technology (ACM)
- A shift to multi-dimensional warfare such as decisive superiority on land and in air and water.
- A shift from selecting axes for the main strike to selecting "areas of concentrating efforts" since the epicenter of an opponent's defenses consists not in positions and lines, but in a fire grouping (i.e., means of nuclear attack, air defenses, anti-tank systems, reconnaissance-strike complexes, and reconnaissance-firing complexes that are widely dispersed).
- An achievement of surprise by the mass employment of technologically new systems.
- Precise coordination of land-, air-, and space-based systems with regard to the objective, place, and time during the conduct of air offensives.

Regarding military-technical policy, the military doctrine describes two priorities: (i) "emerging high-precision, mobile, highly survivable, long-range, stand-off weapons," and (ii) arms, equipment, and C^3I systems whose quality will permit a decrease in the quantity of arms.[32]

Three distinct components of the Russian armed forces are described in the military doctrine: first, a limited number of forces in permanent readiness in various theaters to repel local aggression, second, mobile reserves or rapid response forces capable of quickly maneuvering to any region to repel mid-level aggression together with permanent readiness forces and, third, strategic reserves formed during the threat period and during war to conduct large scale combat actions. The main strategic missions of these forces has remained unchanged from the previous doctrine: strategic forces are designed for conventional deterrence, general purpose forces are for defense and the repelling of aggression on a local or regional scale, and nuclear weapons for nuclear deterrence purposes (now, however, based on the abandoning of the non-first-strike pledge in order to more fully provide for a "flexible response" posture).[33]

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[32]FitzGerald, Mary C., 695, 698, 701-02 and; Mackintosh, Malcolm, 536.

[33]FitzGerald, Mary C., 701 and; Garthoff, Raymond L. 58.

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The hallmark of the new military philosophy has been the transition to a mobile-forces based armed forces. Two types of such forces have been suggested. "Immediate reaction troops" at twenty-four hour readiness based on existing airborne forces with air and naval infantry support are the first line of defense. "Rapid deployment forces" made of army formations, airmobile carriers on frontal aviation, in two-three days readiness, would comprise a secondary force response. Both of these forces would be backed by "large strategic reserves" probably located in the interior of the country on a territorial basis.[34]

Perhaps the most contentious provision in the new military doctrine has been the removal of the nuclear non-first-use pledge. Despite the relatively absent criticism of this revision, the Russian government, as seen by Grachev's and Kozyrev's defense of the doctrine, was quick to dispel any conceptions that this was a provocation or indication toward a preemptive posture. What has changed is not the desire to avoid nuclear war, but a belief on the part of the Russians that its weakened strategic situation may no longer give Russia the option of keeping a war non-nuclear. The burden is thus placed on the aggressor to avoid a nuclear response. With this new defense provision, Russia has indicated that a first-use nuclear response will be warranted if conventional defense does not suffice. Some have argued, however, that this policy is neither strategically nor politically wise. Against states possessing nuclear arms, a first-use threat is simply not credible where as with non-nuclear states it is not even necessary. With realistic strategic planning relevant to the new security requirements coupled with correct military reform, Russia's conventional capabilities should be quite adequate to defensive tasks. Reliance on first-strike posturing may prove to be dangerous and self defeating.[35]

Despite the arguments to the contrary, Russia has unequivocally issued its nuclear threat and has begun to develop its response mechanisms to possible war scenarios within the "near abroad." CIS security maybe assured with a minimum of the required nuclear weapons of the strategic forces together with the combat readiness of

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[34]Mackintosh, Malcolm, 536.

[35]Garthoff, Raymond L., 58; Schmemann, Sergei, A11 and; Arbatov, Alexei G., 38-39.

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the General Purpose forces to guarantee the prevention of military conflict and to rebuff aggression. Of special significance is the principle of strict centralization of nuclear weapons, and "hand-in-glove" coordination with conventional forces linked vertically and horizontally by objective, missions, and time.[36] In short, Russian controlled nuclear forces will be able to offer deterrence in a number of theaters simultaneously.

Major changes in the ground forces have occurred as a result of international agreements (i.e., the CFE treaty) which have demobilized large numbers of servicemen, the withdrawal from Europe and the Baltics, and the emergence of "hot spots" along Russia's borders. As a result of these new situations, the highest priority has been to find and buildup redeployment areas in Russia's eight Military Districts and special regions for troops returning from Germany and the Baltics, and to secure the funds and material for the construction of barracks and accommodations.[37]

Of the remaining forces, the air force has relocated the Air Armies, formerly in Poland and Germany, to the southern regions bordering on the Caucasus, maintained the long-range bomber forces of two Air Armies (one in the west and one in the far-east), although it appears to have upgraded the air force's frontal aviation element to increase its capacity to support the ground forces. The Air Defense Command has retained its one Air Defense District covering Moscow and four other independent armies to protect the rest of European Russia.[38]

The navy has suffered the most as a result of break up of the Soviet Union. Currently, four fleets have been retained: the Baltic, Black, Northern, and Pacific, with a small flotilla in the Caspian. An overall decrease in the number of surface ships and submarines and the loss of access to vital coasts and ports of the FSU has taken its toll on the navy's capabilities. Nevertheless, the navy is expected to play an important role, strategically and tactically in the future of Russia's armed forces. Two new advanced vessels, one cruiser and

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[36]Shaposhnikov, Evgeni, 207.

[37]Mackintosh, Malcolm 537.

[38]Ibid., 537.

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one destroyer, have been commissioned. Further, the planned participation of the navy, especially the infantry, in the mobile forces should not be underestimated.[39]

Conclusions

Although the new military doctrine is explicitly described as intended to serve for the "transition" period, the ideas expressed in it are the embodiment of the military goals and philosophies of the Russian Federation. For the short- to medium-term, Russia will face continued economic hardship, political turmoil, and a host of regional concerns. The way in which Russia manages the interplay of these pressures (i.e., regional instability leading to a need to increase the military presence in the south, while the MOD budget is significantly scaled back) will lay the foundation for political-military relations in the post-Soviet era. Because the current era is so crucial, Russia must develop a stable economic system. Only through economic strength can the needed economic expenditures be met.

The military doctrine of the RF indicates that a number of positive alterations have taken place in military philosophy. What is most encouraging is that Russia has begun the transition to a mobile, reaction based, force structure. Without the massive character of the Soviet army, a sustained presence in the FSU will be more difficult. Moreover, the commitment to search for the "vitally important interests" of the Russian Federation has been offered in the doctrine. Hopefully, this commitment will lead to mutual understanding between Russia and the "near abroad" as well as a cooperative atmosphere in which instability can be addressed.

Despite the positive aspects of the military doctrine, there exist a number of troubling features. First and foremost, the increased rhetorical hard line taken with respect to the use of nuclear weapons is particularly worrisome. Despite the economic troubles faced by the states of the former Soviet Union, the removal of the no-first-use pledge could add impetus to these nations' desire to obtain nuclear materials. The existence of nuclear devices or the threat of nuclear terrorism would only serve to further destabilize the region. Moreover, the credibility of the threats posed by the RF regarding a

[39]Ibid., 537.

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nuclear response is highly suspect. As has been previously noted, against states possessing these weapons of mass destruction, such a threat is not credible; against those without, the threat is not necessary.

While Russia has begun its transition in military philosophy and policy, the road ahead is unclear. What is known is that the journey will be arduous. Only with sustained diligence toward resolving problems in the political arena will Russia keep from straining an already taut military. Further stress could have disastrous consequences.

Acknowledgments

Spencer D. Bakich would like to thank Dr. Stephen R. Bowers and Kate Raikes for contributing to this article.

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Modernizing China's Banking and Financial Sectors

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In 1978, China embarked on a gradual but far-reaching economic reform, as a result of which its economy has been significantly modernized and opened up to the rest of the world. The reform process has affected all sectors of the economy, the most dramatic change having taken place in 1992, when the Party officially recognized that a market system was not incompatible with the ideals of socialism and subsequently proclaimed the idea of establishing a "socialist market economy." This implied an economy in which market mechanisms govern economic interactions but the public sector maintains ownership of the most important means of production.

In the wake of this decision, the Chinese leadership outlined and approved a comprehensive reform strategy which explicitly identified financial reform as a key element in efforts to create efficient financial markets which would strengthen the authorities' ability to effect macroeconomic management using indirect monetary instruments.

Major Achievements Since 1978

Institution building started in the early years of reform with the establishment of a two-tier banking system. Gradually, the People's Bank of China (PBC) was divested of all its "commercial" activities. In 1984, the PBC became China's central bank. However, monetary and credit policy continued to take the form of a credit plan that was implemented through a set of credit quotas for each bank and direct bank financing of enterprises. Since the credit plan was an aggregation of sectoral and local financing needs done from the bottom up, an expansionary bias was inherent in the system. This impaired the PBC's ability to manage monetary developments – a problem that was not really addressed until 1992-93, when work on a new central bank law started. Central banking received a new impetus in 1995 when this law was enacted, giving the central bank the legal foundation to operate in a market environment under the

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leadership of the State Council.

Despite the above-mentioned dilemma, monetary policy's role in macroeconomic management has significantly increased. The PBC has introduced reserve requirements and lending facilities to commercial banks to support its monetary policy actions, which remained guided by the credit plan. However, the effectiveness of the credit plan has been decreasing since the late 1980s, mainly because its institutional coverage has lagged behind the expansion of the banking sector. In 1994, direct central bank lending to the government was discontinued, and preparations for increased reliance on indirect monetary policy instruments were started in earnest.

In the early reform years, four state-owned specialized banks – the Agricultural Bank of China (ABC), the People's Construction Bank of China (PCBC), the Industrial and Commercial Bank of China (ICBC), and the Bank of China (BOC) – were established to improve the allocation of financial resources to specific sectors. Starting in 1984, selected new banks were permitted to operate alongside these four banks, and during the second half of the 1980s, a flourishing network of nonbank financial institutions (NBFIs) emerged. Since then, the four state-owned specialized banks have been used to implement the government's financial policies, as laid out in the credit plan, and other banks and NBFIs have enjoyed more freedom in their operations.

The establishment in 1994 of three policy lending banks, intended to channel credit to infrastructure and other priority areas, and the enactment of China's new commercial bank law in 1995 are meant to encourage market-based management and pricing principals. Chinese lawmakers also intend to separate banking from other business. New legislation designed to regulate and streamline NBFIs is being formulated.

The development of financial instruments has been limited to the capital market. No nationally integrated money market has as yet been developed, and most banks lack the skills to develop new products that could create competition in the financial sector. Local interbank centers have been emerging since 1986. Although they have played a useful role in the local redistribution of surplus funds, they have not operated as interbank markets in the traditional sense. Since NBFIs and even some enterprises can participate, these centers often serve as channels for long-term financing of nonbank and

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nonfinancial institutions, thereby circumventing the credit plan.

The absence of nationally organized money markets – one of the salient features of China's financial sector in the early 1990s – is related to its slow start on interest rate liberalization, its lack of a modern payments and settlement infrastructure, and the banks' inefficient administrative organization. The lack of nationally integrated interbank and money markets has, in turn, hampered efforts to achieve the transition to indirect instruments of monetary policy. In the absence of an interbank market where surplus funds could be redistributed, the existing indirect instruments have been used to channel liquidity from one region or entity to another. The authorities have regulated liquidity by adjusting reserve requirements and using the PBC's lending facilities for banks while maintaining relatively stable interest rates.

Capital market development, though, has become one of the striking features of China's reform process. In 1981, the authorities resumed the issuance of government securities, mainly to complement financing provided through the credit plan. Shortly thereafter, the authorities permitted the issuance of other types of bonds – including enterprise bonds – and enterprise shares, even though they remained strictly controlled in order to avoid conflicts with the priorities set in the credit plan. Since 1988, secondary markets in bonds and stocks have been allowed to operate, which has further boosted capital market development. The stock exchanges of Shanghai and Shenzhen have become the exponents of China's flourishing capital market activity.

For most of the period since 1978, market development and liberalization have lagged behind institution building, at least in the domestic financial sector. An attempt at liberalizing interest rates during 1986-1988 (banks were allowed to set lending and deposit rates freely within specified margins above the administered rates) was brought to a temporary halt in the midst of the inflationary developments of 1988-89. Since the early 1990s, banks and NBFIs have again been granted the freedom to vary lending rates within prespecified margins, with the width of the margin depending on the type of institution.

Market development has made significant strides in the foreign exchange sector. The establishment of swap centers in 1986 marked the introduction of an embryonic foreign exchange market in China.

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Until 1992-93, turnover in this market, which was organized under the supervision of the State Administration for Exchange Control, grew steadily. A new phase started at the beginning of 1994, when the exchange rates between the different swap centers (swap rates) were unified and one national foreign exchange market was created. At the same time, the official rate and swap rate were unified.

How Were Reforms Introduced?

Like reforms in other sectors of the Chinese economy, financial reform has not followed a rigid, comprehensive blueprint but instead has been characterized by pragmatism and gradualism. In short, reform in China has been evolutionary rather than revolutionary. The size and diversity of the economy, as well as the decentralization of decision making early in the reform process, have allowed policymakers to adopt small-scale experimental approaches – which were subsequently adopted in some instances, on a national scale.

Examples of this approach in the financial sector include opening local interbank centers in selected cities in 1986 and secondary markets in government securities in six cities in 1988. In both instances, other cities were allowed to pursue these courses of action after the authorities had received sufficient indications that the initial experiments had been successful. The establishment of stock exchanges at the end of the 1980s is a third example. The local authorities in Shanghai and Shenzhen initially encouraged the development of stock exchanges in their cities without support from the national authorities. In 1990, the central government recognized Shanghai's as the nation's major stock exchange experiment. In 1991, it went on to recognize the development of the Shenzhen exchange. At the same time, stock exchange experiments in other cities were put on hold.

Selectivity in undertaking reforms is closely linked to the experimental approach. From the beginning, the Chinese authorities have selected certain provinces or regions to play leading roles in the reform process. The Special Economic Zones (SEZs) are the most striking examples of this: they were allowed the autonomy to offer financial and other advantages to attract foreign investors. Branches of foreign banks could be opened in the SEZs. Credit quotas were more flexible, and bank branches were allowed more freedom in setting their lending and deposit rates in SEZs than elsewhere in

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China. As a result, economic growth in the SEZs has far outpaced that in the rest of the country.

Intermediate control mechanisms have been established to smooth the transition from one economic system to the other and to familiarize economic agents with the features and mechanisms of the newly emerging system. Examples are the establishment of a two-tier pricing system (1984), the introduction of a swap market in foreign exchange retention rights (1986) to improve the use of foreign exchange, the introduction of indirect monetary policy instruments (1984), the granting of more freedom to the banks in setting interest rates (1986), and the establishment of local interbank markets to encourage banks' liquidity management (1986).

Assessment

Financial development in China started from a very low level, since the financial sector was almost nonexistent, Seen against this background, China's record of financial sector development is impressive; nonetheless, an assessment of China's achievements in developing its financial sector reveals that the authorities have thus far devoted more effort to institutional development than to the process of creating markets, including the liberalization of financial operations, while the development of financial instruments has been confined to the capital markets. This perceived imbalance in development arises principally from the position of China's financial system at the end of the 1970s and the authorities' preference for an intermediate macroeconomic control system.

The monetary sector in particular was at the heart of this control mechanism whereby, de facto, control techniques of a planned economy continued to dominate and market-based techniques served only a complementary role. This combination reflected the authorities' desire to use the newly established financial sector, for as long as possible, as the main vehicle for an interventionist economic development strategy. The line adopted by the Chinese leadership with respect to the role of the emerging financial sector in the economy is very similar to the approach taken by the authorities of several other far east Asian countries and reflects a conviction that maintaining tight control over the sector's price mechanism would ensure that it remained an important vehicle in the government's financial allocation policies.

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Agenda for Continuing Reform

The upshot of the strategy adopted thus far is that future financial reforms will need to emphasize liberalization measures focused on interest rates and the exchange system.

The strategy adopted by the Third Plenum of the Fourteenth Central Committee of the Communist Party in March 1993 implicitly recognized that if the imbalance between institution building and market liberalization in the financial system were protracted, it could become an impediment to further liberalization and a better allocation of financial resources.

To be successful, domestic and external financial liberalization will need to be underpinned by other reforms, including an accelerated commercialization of state-owned banks, establishment of effective banking supervision, and reform of the accounting system used by the banks. Liberalization, in turn, will give a new impetus to money and capital market development and the concomitant development of new financial instruments. These reforms, taken together, will facilitate the development of indirect monetary policy instruments, which will complete China's transition to a market-based financial system.

In 1995, preparations started for the development of a nationally integrated interbank market in 1996 and a phased liberalization of interest rates that is to be completed by 2000. Both projects are to some extent intertwined, since the first phase of interest rate liberalization will focus on interbank rates. A phased interest rate liberalization, starting in January 1996, will allow the authorities to address problems posed by the precarious position of the state-owned enterprise sector – the main reason why interest rate liberalization was postponed for a long time.

Lessons Learned

What lessons can the rest of the world draw from China's experience with the development and reform of the financial markets? First, China's 15-year experience clearly underlines the importance of building a widely and deeply developed banking system. Starting from a system in which a few "banks" operated as government departments assigned to implement the authorities' credit plan and, in fact, had a mere accounting role, the authorities have managed to establish a fairly diversified financial sector with universal

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and regional banks and a variety of NBFIs. While this sector has contributed to the country's high savings ratio and its rapid pace of monetization, it has fallen short as a mechanism for channeling financial resources to the most productive sectors.

Second, one aspect of institution building that did not receive sufficient attention during the first decade of reforms is the enactment of legislation to support financial market development. Central bank and commercial bank laws were enacted as recently as 1995, while other key legislation, covering such subjects as NBFIs and negotiable instruments, is still in preparation. The lack of a solid legislative underpinning has certainly had an adverse impact on China's financial reforms. For instance, as emerging market forces began to have an impact and the financial system expanded, the need to strengthen the supervisory authority of the PBC was strongly felt. Initially, the PBC's relationship with the state-owned banks was only that of *primus interpares*. The PBC managed gradually to establish its authority over the banks and the newly emerging parts of the financial system. Yet the country's political and administrative structure and the tendency to decentralize decision making, in combination with a lack of supporting legislation, initially gave the local authorities more influence over PBC branches and branches of the specialized banks than the PBC's own headquarters had. This unsatisfactory situation was finally addressed by the 1995 central bank law, which established the authority of the PBC headquarters over its branches and the financial sector as a whole.

Likewise, the lack of solid legislation has delayed the commercialization of the state-owned banks. Their protracted dependence on the government and its policies has resulted in their failure to develop financial sophistication and prevented them from making more effective use of market instruments in their operations. In addition, their internal administrative and managerial structures, which gave given branches a high degree of independence vis-à-vis headquarters, make it difficult for these banks to operate as one integrated entity within a market environment. Technical factors, such as the lack of modern accounting practices, aggravate these problems.

Third, a gradual approach to liberalization has perhaps been postponed for too long and may have led to distortions elsewhere in the economy. While the government tried to keep a firm grip on financial market development to ensure that the banking sector

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remained a major vehicle for its financial policies, it could not prevent market forces from making themselves felt and, on occasion, interfering with the government's plans. The emergence of the NBFI sector has no doubt enriched the financial landscape but it has also posed challenges to the government, which was forced to include certain types of NBFIs in its credit? plan to ensure continued adequacy of control. In the government securities market, the "market" itself initiated secondary market trading, which was afterwards allowed officially, but this development also posed some new challenges for the government. For instance, the market increasingly wanted to see secondary market price movements reflected in the prices of primary issues, whereas the government tried to stick to its administratively set prices. In 1993 and 1995, for example, the government had to raise the interest rates on its securities when they were issued, in order to meet the market's demands.

For a long time, political resistance to interest rate liberalization was strong, mainly because of the weak financial position of the state-owned enterprises. The importance of liberalization as the next step in the reform process has now been recognized. This explains why further reforms in China could now, more than during the first 15 years of its reform, benefit by applying the lessons learned by other countries – in particular, the East Asian countries – that liberalized their financial systems and adopted market-based monetary policy techniques.

This subject has been treated by the authors at greater length in "Financial Sector Reforms in China" published in *Finance and Development*, Vol. 33, No. 1, March 1996, and in "Monetary Reform and Exchange System Reforms in China: Achievements and Agenda for the Future," published in the IMF Occasional Papers series (1996).

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The Permanent International Divide?: Human Abilities and National Development

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For a brief period of human history, the 20th century, there was hope that the peoples of the earth would come together in peace and equality. The horrific wars that stretched across the planet became the goad and the symbol of the need for a new order in international relations. Yet, with all the expectations and efforts to create a world system to achieve these goals, the final years of this century may be remembered by the increasingly impotent efforts of the world community to dampen down, let alone reverse, the growing levels of chaos and tragedy.

The human, and thus the historical challenge, to all who are living through what should be seen as a new watershed in the social evolution of the peoples of the world, is to understand what is today happening to this world, in social, biological, and physical terms. To be able to do this, we must shed the misunderstandings that have clouded the vision of the educated leaders of the past. It is they along with their ideological infatuations that have in war and genocide tainted the process of internationalization with the blood of the better part of 100 million human souls.[1]

Many serious books, most recently by Robert D. Kaplan and George P. Kennan, have been written that now echo a new and ominous sense of fear and futility that many educated people see for the future of our world.[2] There is developing a sense of

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[1] Rummel, R. J. 1994. *Death by Government.* New Brunswick, New Jersey: Transactions Publishers, pp. 1-28. See also: Mayer, Arno J. 1988. *Why Did the Heavens Not Darken?* New York: Pantheon, p. 4. Mayer argues that between 1914-1918 and 1939-1945, about 100 million lives were lost, 80 million in Europe. Between the two World Wars, and from 1945 until the mid 1980s, another 50 million people were killed through war and genocide.

[2] Kaplan, R. D. 1996. *The Ends of the Earth, A Journey at the Dawn of the 21st Century.* New York: Random House; Kennan, G. F. 1996. *At a Century's Ending, Reflections, 1982-1995.* New York: W. W. Norton. See also: Wilson, E. O. 1992. *The Diversity of Life.*

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irreversibility in the worldwide drift into ecological, economic, demographic, and social disintegration. Much of this sense of impotence derives from the paucity of convincing solutions to trends that now seem almost determined.

Having been disenthralled of the ideological utopias that have caused so much horror in the 20th century, and this after the sober anticipations of hope and possibility that technology and science had opened up for humanity at its beginning, it is no wonder that the most educated classes in the most advanced nations live in a values vacuum, having no persuasive philosophical commitments to shape their lives. Such personal bewilderment has historically been a prescient indicator of deeper apperceptions of loss.

A Developing International Crisis

My argument in this article is that we must turn to a more fundamental stratum of explanation if we are to obtain intellectual and then policy control over the various national and international trends that are today developing. The post-Cold War euphoria having quickly abated, it is clear that, indeed, "history" is still with us, and presenting a number of awesome challenges.

The deeper level of analysis that I propose lies in the bio-social understanding of the dynamics of human nature and human intelligence variability as it spills itself out in the historical impacts of interacting individuals, their ethnicities and nations, now within a rapidly shrinking international context.

The 20th century has truly brought humankind together, in all its variability and diversity of historical experience, as has no other century of the past. This point is axiomatic and noncontroversial. What is controversial is to view this new international context in terms of not merely accidental or incidental geographical and historical diversities of human experience, but of more fundamental bio-social factors that fundamentally determine individual behavior and national destiny.

This analysis unequivocally refutes the by-now threadbare ideological and sociological environmentalism that has heretofore

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Cambridge: Harvard University Press; Kennedy, Paul. 1993. *Preparing For the 21st Century* . New York: Random House.

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undergirded sociopolitical policy in the liberal democratic West as well as the socialist totalitarian East.

At least one million years ago, ancestral groups of hominids left their African genesis, marking the first large-scale emigration of humans in search of a vision. It has happened many times since, ultimately overlayering the original geographic races. Today, one cannot speak definitively about racial differences. It makes much more sense to focus on the existing ethnicities that, for example, today divide the Igbos from the Hausas, the Chinese from the Japanese, the Bosnian Serbs from their Muslim neighbors, even African-Americans from European-Americans.

What is, however, critical about these ethnic differences, as I shall argue below, is that ethnicity carries with it not merely cultural variation but, very often, bio-social differences in intellectual capacity and quality. These scientific facts are today clearly explainable through both evolution and history.[3]

Until the middle of the 20th century, such differences were largely below our consciousness, except for the incubus of African racial slavery, which has over the past several centuries effected an enormous swathe of territory adjacent to its origination in the African continent, now to include large portions of the Western hemisphere. In our own time, the historical separation of the peoples of the human race has become an artifact of memory. There is no escaping the fact that what happens anywhere in the world will rapidly affect lands on the other side of the planet: pollution, ecological degradation, the demographic explosion and its consequent migration upheavals, the pandemic of AIDS, and now tuberculosis.

The new element in this contracting planet is that, by contrast, early in the 21st century it will have become clear that the supposedly temporary membrane that separates the standards of living and civilizational profiles of the so-called developed social classes from the Third World will have become an impermeable barrier. Hopefully, the older conceptualizations will by then finally be seen as bankrupt instrumentalities for national and international policy making.

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[3] Itzkoff, S. W. 1983-1990. "The Evolution of Human Intelligence." New York: Peter Lang International Publishers. A series of four books in which is presented the scientific evidence for the inevitable conclusions.

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Given the continuation of present historical trends, by the middle of the next century the nations of the so-called developed world will have entered into a far more interconnected association of relatively wealthy and democratic societies. Other nations and regions may by that time be descending into the chaos, conflict, and tragedy that increasingly characterize societies with stratified social classes, a majority of the population impoverished. Japan and the Scandinavian nations are examples of the former; India and Brazil represent the latter.

Even more unsettling to the international order, large portions of the world, encompassing numerous stricken peoples, are labeled by the United Nations as *failed nations*. They may well be beyond social and political redemption. In Africa, Bangladesh, Haiti, for example, all having a disproportionate percentage of their populations living in utter impoverization and degradation, often under despotic control, may well be beyond the resuscitating capacity of the developed nations. In fact, such tragedy may soon lie beyond the reforming moral will of humanity, given the extent and the depth of the then-existing international crisis.

21st Century Civilizational Divisions

In attempting to divine the evolving nature of a post-Cold War world, Samuel P. Huntington, sees a separation of the international community into "civilizational" blocs, of which the West is but one, at least temporarily, dominating. The other blocs include an Eastern Orthodox grouping in the former domains of the European Communist world, an Islamic, Latin American, Japanese, indeed, even a coming together of an alliance of Confucian-Koranic heritages:

> ...Differences between civilizations are real and important; civilization-consciousnessis increasing; conflict between civilizations will supplant ideological and other forms of conflict as the dominant global form of conflict; international relations, historically a game played out within Western civilization, will be increasingly de-Westernized and become a game in which non-Western civilizations are actors and not simply objects; successful political, security and economic international institutions are more likely to develop within civilizations than across civilizations; conflicts between groups in different civilizations will be more frequent,

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> more sustained and more violent than conflicts between groups in the same civilization; violent conflicts between groups in different civilizations are the most likely and most dangerous source of escalation that could lead to global wars; the paramount axis of world politics will be the relations between 'the West and the Rest'; the elites in some torn non-Western countries will try to make their countries part of the west, but in most cases face major obstacles to accomplishing this; a central focus of conflict for the immediate future will be between the West and several Islamic-Confucian states.[4]

Huntington is correct in noting the separation of the West from a number of regions of our world. He is also perceptive about the role of minority elites in a number of predominantly non-Western-type nations as attempting to bring these nations into the Western camp. Clearly, Mexico and India are examples of those now-evolving internal struggles.

However, I believe Huntington to be in error about the place of Japan, and then Korea and the various Chinese ethnic nationalities, including those in Mainland China. In the case of Japan, Japan's increasing penetration of Western markets has to have had an impact on the Japanese sense of relatedness. Also increasing is the number of Japanese-Western business partnerships, effectively unifying the Western-Japanese economies.

The penetration of Western culture into Japan has impressed all returning visitors, despite its conscious retention of its cultural heritage. After all, one crosses the Alps from Austria into Italy with a jarring sense of cultural change. Are the lives of Austrians and Italians really less different from the lives lived by the Japanese and American middle classes? Japan is now in the throes of a democratic political revolution, suspiciously Western in character. And, above all, is there no significance to the fact that Japan has effectively subjugated the West, in but 40 years, through its well-learned internalization and mastery of Western science and technology?

A similar argument can be made with regard to the still-evolving Chinese national entities, and, of course, to the Koreans, who are not

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[4] Huntington, Samuel P. 1993. "The Clash of Civilizations?" *Foreign Affairs*, (Summer), 48.

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far from having a population majority of Christians, and a highly sophisticated scientific, educational, and economic infrastructure, to boot. Theirs is a society ever more democratic, politically, all part of their enthusiastic integration into the Western civilizational camp. The same will soon be said about Eastern Europe. The war in Bosnia will eventually come to be thought of as a special case of historical retribution, tragic, for the Bosnian Muslims are Western - educated. Their religious heritage would probably have slipped quietly into their historic cultural memory in the same way that Shintoism and Confucianism have quietly disappeared in their respective nationalities.

Similarly, amidst momentary travail, this transformation can be seen among the Central Asian Republics of the former Soviet Union. Throughout this vast area, from the Elbe River to the Pacific, a great shift toward the West is in the making. Indications are that the intention of these peoples is to enter upon the pathway of economic and political liberalization and the continued forging of cultural bonds with the West. And, indeed, as with the Chinese, the bio-social profiles of these peoples strongly suggest that the connection between will and fulfillment is likely to be crowned with much more success than that of the efforts by the Western-oriented elites of other nations for their masses.

This misapprehension as to the nature of future international conflicts, even competition, arises from a misunderstanding of the nature of the dominance of the West in the contemporary world. It is a cultural one, indeed, but one built on a cultural platform of high on-average intelligence and the education that perfects this intelligence. This has produced symbolic structures of knowledge of deep abstraction as well as the resultant instrumental institutional skills to create a living social expression of this intelligence. Call it Civilization: modern, industrial, universal.

The result is a dynamic scientific and technological culture that thrives in an environment of political and economic freedom. What the West shares with its member constituents at the end of the 20th century is a formed cultural order cemented into mutual inter-dependence by the techno-economic achievement of the middle classes around the world. Some nations such as Japan and most of Western Europe are more or less uniformly classless societies, the fulfillment of the dream of Karl Marx, achieved through a revolution

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in the modes of production, theoretically predicted by Marx, but regrettably unforeseen at the beginning of the 20th century's ideological hallucinations.

Indeed, I think it is not fantasy to hypothesize that 99% of the world's populations would abandon much of their home cultural *Weltanschauung* for the entire package of Western institutions, including their democratic secular forms. The caveat is that they would do so if they could personally attain such a life style. The flood of immigration out of these nondeveloping nations for a small piece of the Western action, epitomized in the social welfare subsidies available to all who so arrive on the various Western "shores," constitutes persuasive evidence.

Finally, the spread of "religious" fundamentalism and terrorism. My suggestion is that we examine these worldwide phenomena with less credulous eyes. Could it be that such trends take hold in populations that are frustrated in their natural yearnings for the life style of the West because they cannot muster, in a *macro* sense, the educational and economic accomplishments that naturally flow from more advanced bio-social profiles?

The frustrations and sense of defeat must be sublimated and transferred to other and external social expressions regardless of their instrumental effectiveness. The mindless terrorism, killing, and chaos we see throughout the Third World, as well as the epidemic of criminal violence in the underclass in Western countries, are a sad but ever more common expression of such failures, rather than a real philosophical political trend in our world.

Economic Development: The Visible Barrier

Just as the iceberg shows only a small portion of its enormity in what we see above the surface of the waters, so, too, economic development is the visible manifestation of national, ethnic, and individual capacities precipitated into visibility by the intellectual differences that still divide the human species.

It is axiomatic that this unfolding of humankind's universal drive for modernity is hardly complete. The ideological, religious, and plainly tychistic causes that still keep nations, peoples, and individuals from realizing tangible personal and national fulfillment are tangibly evident.

The Soviet and other socialistic forms of social life, given the

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totalitarian and ideologically coercive institutional policies they engendered, destroyed generations of talented and educated humans behind the Iron Curtain. Today, religious fundamentalism and unlimited tyranny impede many other peoples from exercising their natural ambitions to educate themselves and free their talents within their own societies.

The world order has assumed the responsibility for actions that would give these millions, if not billions, of humans a chance, whether they live in Haiti, Saudi Arabia, Syria, North Korea, or Liberia. Yet there is enough evidence in the 40 or so years since the dissolution of the traditional colonialisms that, for large portions of the world's population, where there was real hope for liberation and prosperity, things have not gone in the direction that was expected in that initial euphoria. In fact, the burdens that the colonialist West supposedly inflicted on these peoples are seen now as gifts that were squandered. The responsibility of national development, as it has been for millennia, is internal. It has to happen from within, from the natural human thrust toward self-actualization, limited only by each people's vision of what is possible.

In the developed and developing world, peoples and nations are advancing at a galactic rate beyond that of large portions of the Third World. The mainland Chinese, now in process of throwing off the Maoist madness, are growing economically at a rate of 15% per year. Theirs is now rated as the third largest economy in the world. Estimates are that 80% of its city dwellers now own color T.V.s.[5] In the villages, ultra-sound equipment is now widely available. It is widely used to predict the gender of the unborn, leading to a 118 to 100 predominance of males born over females. We may not approve of the morality of such a response to the Draconian birth restrictions of the government. Yet the present number of children to be expected of every female in the birthing cohort is down to 1.7, well within the European rate.

The rapidity with which the Han Chinese ethnicity is responding to the opportunities for entering the world of Western standards of living mirrors its high I.Q. scores, 110 in some Singapore and Hong

[5] See *The Economist* (5/15/93, 83; 5/22/93, 39; 5/29/93, 13) on the tremendous surge of this society through domestic and foreign investment. Taiwan alone is estimated to have invested between $15-25 billion in Mainland China in the past 10 years.

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Kong tests, high educational achievement levels in international testing surveys, and overall in its disciplined family and social profile.[6]

How has this exuberant burst of productive energies come about so as to lift, in a blink of time, the standard of living of average Chinese citizens, 1.14 billion of them, above the poverty line? Certainly, the wage rates are low, but no lower than in many parts of the developing and Third World. In terms of current massive international investment, it is clear that the developed world views China, and thus the intellectual and educational skills of its people, as a wave of the future.

Here is an ancient literate civilization whose potential was held in political and ideological bondage for too many centuries. Its people are now prepared for this exhilarating release into social and economic freedom. That this new and evolving Western cultural tradition has not been externally imposed upon this people, but has grown indigenously out of its own genius, is exemplified in Mainland Chinese international educational performance.

A 1991 comparison of the math abilities of 13-year-old students throughout the world (published in 1992) demonstrates the relationship of cultural readiness for participation in the Western system. This age level is considered to be the earliest reliably predictive age for future educational and vocational achievement. Because so many Chinese were either not in school or else in grades lower than 7th, the cohort test included only a subset of 425 million people out of the total population, thus denying the achievements in math the highest measure of reliability.

But they were the highest scorers of all the 13-year-olds who were tested, 80. Taiwanese and Korean students scored at the 72-73 level. No Japanese or German students were included. Other West and East European 13-year-olds scored in the 67-70 range, the latter then in the midst of great revolutionary turmoil.
United States 13-year-old Junior High School math students scored 55, somewhat higher than Third World students.[7]

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[6] Seligman, Daniel. 1992. *A Question of Intelligence*. New York: Birch Lane, p. 122.

[7] Lapointe, A. E., *et al.*. 1992. *Learning Mathematics*. Princeton, New Jersey: The International Assessment of Educational Progress, Education Testing Service (Feb.).

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The implications as to what is occurring in China from the standpoint of the theory of modern economic development is crucial to understanding the shape of the next century. Attested to by economists of all political stripes, including Lester Thurow of MIT, Robert Reich, formerly of Harvard, now in the Clinton administration, the educability of a national workforce stands preeminent in predicting the future of any nation having pretensions for achieving a modern Western classless society.

International economic and political discourse is today constructed from the life-style demands of the educated Western middle classes, whether the demands be autos, VCRs, designer clothing, country homes, foreign vacations in desirable locations, modern medical care, or cultural institutions: the opera, libraries, parks, higher education for their children. These are not merely the desires of Japanese, Americans, or Germans. All humanity aspires to these amenities in the context of a peaceful social and democratic political setting.

To obtain them, a nation or an individual must produce those items or services that the middle classes of the world desire. This is why statesmanlike leadership emphasizes free trade. In the give and take of market competition, the best and most efficient will presumably win out, and the consumers and producers of the world will mutually benefit.

Conflict and competition in the world of the early-21st century will probably center on these issues of economic production and distribution. Which nations of the world will be able to obtain leadership positions in producing those artifacts and services that are most desirable to this new international middle class? Which nations will be able to produce that which is unique and desirable? Which nations will thereby be enabled to obtain the highest markups, sufficient to pay for the goods and services that their own people desire, to maintain the domestic infrastructure, even to save enough as a reserve for unexpected national emergencies?

Lower down on the international scale will be those producer nations today exemplified by Mexico and Malaysia, that can produce those machines, gadgets, products, that require lower level skills, along with cheap wages and national cost structures: taxes, environmental controls, health costs, legal and bureaucratic overhead – always in comparison with the First World nations.

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Lester Thurow has emphasized that the key to economic leadership among the nations of the world has shifted from natural resources, financial investment wherewithal, large labor forces, even the invention of new technologies and services. In his view, the so-called process technologies, quickly developing new inventions and ideas that are rapidly disseminated throughout the developed world, have become critical to a nation's place in the hierarchy of national power and wealth.

Of course, such a situation could change were international agreement on intellectual property, patent and copyright protections enforced. In those crucial existing process technologies – semiconductors and computers; commercial aircraft; machine tools; textiles; materials and chemicals; motor vehicles; consumer electronics, chips and microprocessors; machine tools – Thurow feels that a historic shift has occurred in both labor and productivity:

> If the route to success is inventing new products, the education of the smartest 25% of the labor force is critical...If the route to success is being the cheapest and best producer of products, new or old, the education of the bottom 50% of the population moves to center stage...If the bottom 50% cannot learn what must be learned, new high tech processes cannot be employed."[8]

The argument is that creative ideas are now readily available and communicable in a flash of a satellite computer message across the oceans. However, the ability of a nation or a people to bring to bear the design, engineering, production, quality control, marketing skills so as to beat out the other nations in quickly bringing such products into the international marketplace requires a work force, down to the lowliest shipping clerk, that is uniformly skilled and efficient beyond the reach of the competition.

This the Japanese and the Germans have been able to achieve in a wide variety of productive technologies in the post-World War II era. We need not elaborate on the wealth that has poured into these nations. Today, both Japan and Germany have used this surplus wealth to established new forms of commercial suzerainty over their neighbors. There is no doubt today that Japan has

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[8] Thurow, Lester. 1992. *Head to Head.* New York: Wm. Morrow, p. 52.

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achieved its almost century-old plan to create an Asian "co-prosperity zone," now far outspanning its thwarted imperialistic program of the 1930s. This expansionism eventually led to their ill-fated attack on Pearl Harbor.

Japanese businessmen now pride themselves on having shifted the assembly stage in the manufacturing process to a wide variety of satellite outsource facilities in Mainland China, Thailand, the Philippines, even the United States, where cheap, relatively unskilled labor keeps costs down. The design, engineering, and marketing stay at home. These remain high-skill, high-value services that are not duplicable in the less skilled nations. The wealth continues to pour in.

It will be interesting to discover the extent of the impact of a very expensive yen, in relation to the dollar and other currencies, on the Japanese economy. The view of this writer is that, considering the extent of the fabricating costs now delegated to cheap labor and currency nations, the impact will be relatively minute.

National Power and the New Hierarchy

The international era that we have entered is similar to the post-Alexandrian Hellenistic as it was unified politically under Roman hegemony. From north England to the Euphrates River, from North Africa, including Egypt and North Arabia, to France, the Rhine and Danube rivers, the Black Sea, one culture dominated for almost a thousand years.

Burial caches of sixth century B.C. Hellenic Greek jewelry and other craft artifacts have been found from the Volga plains to the foothills of the Alps, testimony to the interests and sense of value of ostensibly primitive hunter-gatherer peoples. The lure of civilization is perennial, then as today.

This ancient international civilization was a product of the European-West Asian mind, literally of the same people who 30,000 years earlier had, under glacial tundra conditions of hunting and gathering, from what is today Spain to the Ural Mountains, carved out the first civilization of *Homo sapiens sapiens*.

At the time of Alexander's Macedonian Greek conquests, another people carrying East an ancient Indo-European cultural tradition as well as a Central Asian Altaic linguistic heritage, crossed from Korea to the islands of today's Japan. They overran and

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acculturated the indigenous peoples, and today, roughly 2,300 years later, in Tokyo you will find more fully professional symphony orchestras than in New York City. A goodly amount of European music may be easily encountered in Seoul, Shanghai, Hong Kong, and Taipei. At the Juilliard School, in New York City, almost 50% of the students are from these three northeast Asiatic ethnicities. They are studying piano, violin, classical "Russian" ballet, Italian operatic technique. Think of the evolving industrial civilization as being an international club. It is open to all, no matter the race, ethnicity, nationality, gender. The entrance dues, however, are high. One must earn one's way in. All the philanthropic handouts by the West to the so-called underdeveloped peoples have turned to dross. The dues have not been met.

London School of Economics studies conclude that the tens of billions of dollars poured into the Third World from the developed nations in recent years have only served to perpetuate the exploitive bureaucracies that prosper while their nations disintegrate. Those who think that they can one day appropriate the entry fee do it the "Japanese" way.

Start out with the low-wage, low-skilled assembly tasks. Take what is left over from the $.50- to $2.00-per-hour jobs and invest it in education and infrastructure. Prepare for the next stage of higher-valued productivities and services by building up the skills of the people both on the job and through the schools. Above all, build a first class, high standard secondary school system. Eventually, in the future create the conditions for a research-oriented university system. In the long run, it will be the creativity of the finest national minds that will develop the new technologies, industries, and services that could catapult a nation from the mass toward the pinnacle, where one no longer has to worry about Japanese or German interest rates, the value of the yen or the mark.

Mexico will be a test case for this scenario, in terms of its ability as a nation and a people to move through the stages implied by the above model. It is already involved in second-stage productivities in the automobile and consumer electronics industries, even while its low wages and low costs are putting U.S. semi-skilled workers into the unemployment benefit lines.

Each year, Mexico graduates approximately 145,000 literate and technologically sophisticated young people from its specialized

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secondary schools, technical institutes, colleges and universities. Time will tell about the fundamental intellectual potential of these 90 million people. It will be revealed in their broader social and organizational skills as well as their ultimate educational levels of achievement. Economic development has as its precondition not merely certificates, diplomas, and degrees, but truly high intellectual attainments.[9]

That is why Taiwanese Chinese students who in the last several decades have appeared at the top of international math and science comparisons have in a literal blink of an eye catapulted this resource-barren refugee island into a national center of advanced technology. In barely twelve years, Taiwanese manufacturers have moved from producing $8.5 million worth of computer equipment in 1980 to $7.6 billion in 1992. They now are third in the entire world in terms of the value of these products.[10] In 1996, they are a full democracy.

We should expect to see the continued expansion of bilateral and multilateral trade agreements, NAFTA, the G-7, EC-Maastricht trade and ERM currency agreements. Where nations need each other to thrive, to continue to maintain the *world class* standard of living that their citizenry demands, open markets and a measure of national self-discipline will be *de rigueur* for policy makers.
However, the tacit international understanding will be: we agree not to go for the jugular as long as we need you and your national productivities. If you for any reason fall behind in the international competitive race do not expect us to bail you out except for minimal amounts of conscience money, as with the Third World.

We see this attitude developing in recent German and Japanese behavior. The Germans consider their own national interests first when their neighbor's interest rates soar and/or their currencies plummet. The European Community indeed! First comes our own nation, our own ethnicity.

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[9] see Harley Shaiken. 1993. "Two Myths About Mexico," *New York Times*, 22 Aug.; also an extensive report on Mexican industrialization in *New York Times*, 3/21/93.

[10] The Taiwanese lead the world in the production of systems boards and monitors, components for the international computer corporations. They have followed the Japanese lead and invested the vast proportion of their profits overseas, now Mainland China. Thus, the difficulty they are having financing their $300 billion bond issues, intended for Taiwanese infrastructure modernization.

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The Japanese are increasingly obstinate in submitting to the importunings of the United States to open its markets. The truth is that the Japanese individual consumes or uses about the same value in American products and services as the individual American purchases of Japanese products. Of course, there are twice as many Americans as Japanese.

Let the American government try to coerce the Chinese into not abusing human rights or pirating CDs and computer software. They will simply buy their civilian passenger airfleet from Airbus, not Boeing.

And thus, the Japanese and East Asian advantage grows. Smiling the while, the Japanese shuffle their feet and weep dry tears about their current "recession," even while the hundreds of billions of dollars flow in from their colonial economic empire. The Germans likewise worry little about the fate of the British pound or the French franc as they strive to absorb the eastern provinces, eventually to unify economically with those parts of Eastern Europe that have broken free from Soviet control and which the Germans were not able to retain during the Second World War.

This hierarchical bi-polar world-in-the-making will not be a matter of all or nothing. The fact is that below the dominating nations – those that, as presently with western Europe, can provide all their citizens with something approaching first-class living standards – there will be many nations attempting to maintain at the least a symbiotic economic and political connection with the dominant powers.

We see this today in the so-called developing nations, such as Thailand and Malaysia, Mexico and Venezuela, that have substantial middle classes. India constitutes a different sort of problem, with a middle class of between 85-120 million people. But these constitute only 10-15% of a total population of close to 900 million souls, culturally divided, and deeply impoverished.

As Edward Gargan reported in February, 1994, in *The New York Times*, after almost three years as head of their New Delhi Bureau, India is rapidly dividing itself into a new caste system of the educated

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and the impoverished.[11]

The lure of westernization, the dissolution of redistributionist ideological dreams, may for a time decrease the volatility of political and social unrest in all such nations, but only if the current demographic explosion, and the consequent potential ecological catastrophe, is somehow reversed.

Conclusion

The bi-polar world of technologically advanced middle-class societies versus ever deepening poverty and social disintegration in those nations unable to muster the intellectual, educational, and thus the economic dues to join the international system, constitutes only one cross-sectional perspective on the future. There are other nations that are deeply divided within themselves in terms of their prospects for social and economic development.

The United States is seen as a potential member of this latter group of nations, *class-riven*, and at risk. They are at risk because large and/or growing proportions of these populations cannot master the intellectual, educational, and thus the vocational requirements for full participation in the Western compact for social equality.[12] Such nations constitute perhaps the most incendiary dimension of 21st-century national dynamics and survival. They also constitute an as yet limited, but potentially violent, check on all plans for the pacification of international relations. These are the only, if significant, limitations on the ultimate universalization of modern, technologically advanced society.

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[11] Gargan, E. 1994. "Shackled by Past, Racked by Unrest, India Lurches Toward Uncertain Future," *The New York Times*, February 18.

[12] Itzkoff, S. W. 1994. *The Decline of Intelligence in America, a strategy for national renewal*. Westport, CT: Praeger Publishers. The economic, educational, and social evidence.

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Recruitment of American Presidential Nominees and Appointees: Divestiture and Deferred Taxation of Gain

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It is the thesis of this article that the deferred taxation of gain provision of the Ethics Reform Act of 1989,[1] has become an extremely important tool for easing the transition of individuals from the private sector into positions as presidential nominees and appointees. The success of the deferred taxation of gain provision has ended the search for an effective remedy for the financial conflict-of-interest problems of presidential nominees and other political appointees.

A president, prior to the Second World War, could pick up the phone and ask an individual to serve in his administration and announce the nomination in less than twenty-four hours. Today, the process of selecting a presidential nominee for a high-level administration position can take weeks. Ethics officials working in the White House Counsel's Office, the Office of Government Ethics, the Department of Justice, and the nominee's designated agency ethics official must spend hours carefully reviewing the financial affairs of the prospective nominee, the nominee's spouse, and minor children to see whether they present conflict-of-interest problems. If conflict-of-interest problems appear, additional time must be spent to resolve these problems prior to any announcement of a nomination.

The passage of the deferred-taxation-of-gain provision of the Ethics Reform Act has greatly simplified the process of working with presidential nominees and other political appointees to resolve financial conflict-of-interest problems.

Mandated Divestitute and Deferred Taxation of Gain

The 1992 election of Bill Clinton as President of the United

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[1]. Pub. L. No. 101-194, 103 Stat. 1755 (1989).

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States ended twelve years of Republican control of the White House. President Clinton faced the difficult task of filling hundreds of high level positions with individuals who could withstand intense public scrutiny of their personal and financial affairs.[2] Like all presidential transitions since the early 1960s,[3] the Clinton transition carefully reviewed the financial affairs of potential nominees and appointees for possible financial conflicts of interest.[4] Compliance actions by presidential nominees and appointees, prior to the passage of the Ethics Reform Act of 1989, most often involved: (1) creation of either a "qualified" or "diversified" blind trust, (2) executed recusal or disqualification agreements, (3) resignation from positions in corporations or other organizations, and (4) the sale of stock or other assets.[5] The Clinton transition was the first to have the opportunity to make use of the non-recognition-of-gain provision of the Ethics Reform Act of 1989.

The Ethics Reform Act of 1989 added section 1043(a) to title 26 (federal tax laws), *United States Code*. This section is entitled "Sale of property to comply with conflict-of-interest requirements."[6] The new tax provision "permits an officer or employee of the executive branch of the federal government to rollover any gain on property sold in order to comply with any conflict of interest requirements into

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[2]. For a complete listing and biographical data on high-level Clinton Administration political appointees and nominees see: Jeffrey B. Trammell and Gary P. Osifehin, *The Clinton 500: The New Team Running America* (Washington, D.C.: Almanac Publishing, Inc. 1994).

[3]. G. Calvin Mackenzie, "If You Want to Play, 'You've Got to Pay,' Ethics Regulation and the Presidential Appointments System, 1964-1984," in G. Calvin Mackenzie, editor, *The In-and-Outers* (Baltimore, Johns Hopkins University Press, 1987), pp. 83-87 (hereafter cited as Mackenzie, "Regulation").

[4]. The president appointed Beth Nolan, Associate Counsel to the President with primary responsibility for screening nominees and appointees for ethics violations. See Trammel and Osifehin, p. 13.

[5]. Mackenzie, "Regulation," p. 84.

[6]. "Tax Notes: Executive Officials May Be Entitled to Deferral of Gain," *The Army Lawyer*, (July 1990) DA PAM 27-50-211, p. 52.

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permitted property."[7]

Besides permitting the covered executive branch officer or employee to make use of the provision, the law permits the spouse or minor children to apply for and receive a certificate of divestiture from the Director of the Office of Government Ethics OGE) or the President of the United States.[8] Trustees, finally, have the right to request a certificate of divestiture on behalf of a federal employee who has given the trustee responsibility for managing his or her financial holdings.[9] The law does not limit the number of certificates of divestiture an employee or family member of the employee can receive or the amount of capital gain subject to the rollover provision. These features make certificates of divestiture an extremely effective remedy for financial conflicts of interest.

The Evolution of Financial Conflict Resrictions and Remedies

Since the early 1950s, federal ethics officials and presidential transition scholars have searched for ways to balance the need to prevent financial conflicts of interest with the impact of financial conflict-of-interest rules on the recruitment and retention of presidential appointees and nominees.[10] Critics of conflict-of-interest regulation argued that these restrictions deterred many individuals

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[7]. "Qualified Rollover Can Also Avoid Conflict of Interest," *The Journal of Taxation*, v. 73 (September 1990), p. 138 (hereafter cited as "Qualified Rollover").

[8]. Ibid.

[9]. This situation most often occurs when an executive branch employee has set up a "qualified " or "diversified" blind trust under the provisions of the Ethics in Government Act of 1978. To comply with the provisions of the Ethics Act, trustees frequently must sell certain financial assets. The Ethics Reform Act of 1989 did not permit trustees to apply for a certificate of divestiture. The 1990 Amendments to the Ethics Reform Act added this provision. Eleven trustees received certificates of divestitures for the reporting years of 1990, 1991, 1992 and 1993.

[10]. See Robert N. Roberts, *White House Ethics* (Westport, Conn.: Greenwood Press, 1988)(hereafter cited as Roberts, *Ethics*); Mackenzie", "Regulation"; and G. Calvin Mackenzie, "Presidential Transitions and The Ethics in Government Act of 1978," *Sourcebook on Government Ethics for Presidential Appointees* (Washington, Administrative Conference of the United States, December 1988)(hereafter cited as Mackenzie, "Transitions").

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from accepting high-level positions in government.

The search intensified after the confirmation problem of a number of Eisenhower Administration appointees. President-elect Eisenhower, one month after his election, nominated Charles E. Wilson as secretary of defense. Federal law did not require that nominees to Defense Department positions sell financial holdings in companies doing business with the Department. However, the Senate Armed Service Committee had a policy requiring presidential nominees to the "Defense Department divest themselves of stocks valued at $10,000 or more in defense-related companies."[11] Wilson subsequently informed the Armed Services Committee that he had severed all ties with General Motors but intended to retain 39,400 shares of stock.[12] Wilson made matters worse, when responding to a question from a senator regarding his ability to be objective with respect to matters involving General Motors, he stated "I cannot conceive of one because for years I thought what was good for our country was good for General Motors, and vice versa."[13] The Senate Armed Service Committee refused to back down and Wilson sold his General Motors stock. It is assumed that the sale subjected Wilson to significant unanticipated capital gains taxes. Partisan politics, throughout the 1950s, prevented serious deliberations regarding how to ease the transition of business executives into positions as presidential nominees.

Ethics Reform: Financial Self-Dealing and the Disqualification Rule

On October 23, 1962, President Kennedy signed into law the most significant revision of federal bribery and conflict-of-interest laws this century.[14] Few at the time realized the impact the law would have on the regulation of federal executive branch ethics and

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[11]. Roberts, *Ethics*, p. 59.

[12]. Ibid.

[13]. U.S. Congress, Senate, *Hearings before the Senate Committee on Armed Services on the Nomination of Charles E. Wilson to be Secretary of Defense, 83rd Cong., 1st Sess.* (Washington, D.C.: Government Printing Office, 1953), p. 15.

[14]. Public Law 87-849; See "Congress Amends Conflict-of-Interest Laws," 1962 *Congressional Quarterly Almanac*, p. 385.

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the impact of its provisions on the recruitment of presidential appointees and nominees.[15] Besides bringing together the major federal bribery and conflict-of-interest laws into one section of the federal criminal code,[16] the revised law expanded the scope of these statutes.

Most important to future presidential nominees, the law put on the statute books a new criminal financial self-dealing rule for all executive branch employees and officials.[17] Section 208 of title 18, *United States Code*, prohibits an executive branch official from taking action with respect to particular matters in which the official, his or her spouse, minor children, business associates, or entities in which he or she holds a fiduciary position have a financial interest.[18] "Section 208 does not prohibit any executive branch official from holding any particular type of financial interest or engaging in any type of financial transaction. Section 208 is a disqualification or recusal statute, in that it only prohibits an executive branch official from participating in an official capacity in any particular matter which may affect a financial interest held by the official, the official's spouse, minor children, business associates and certain other entities."[19]

The language of section 208 has created numerous problems for federal ethics officials. Even though the language of section 208 does not require an official to sell a financial asset, disqualification has serious disadvantages. Frequent recusals may prevent presidential

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[15]. See Roberts, *Ethics*, pp. 99-103.

[16]. 18 U.S.C. 201-209 (1988).

[17]. "Congress Amends Conflict-of-Interest Laws," 1962 *Congressional Quarterly Almanac*, p. 386.

[18]. Ibid.

[19]. Robert N. Roberts, "A Guide To Federal Ethics Laws For Presidential Appointees, Report to the Administrative Conference of the United States, November 1988," in, Office of the Chairman Administrative Conference of the United States, *Sourcebook On Governmental Ethics for Presidential Appointees* (Washington, D.C.: Administrative Conference of the United States, December 1988), p. 18. (Hereafter cited as Roberts, Guide.)

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appointees and nominees from effectively discharging the duties of the position to which they have been appointed.[20] "Depending on the extent of a given official's holding and the scope of his responsibilities," argues one commentator, "an effective disqualification could prevent an official from participating in a great many actions that would otherwise require his attention and at some point thoroughly undermine his ability to function."[21]

When Congress enacted the 1962 bribery and conflict-of-interest reform legislation, it included provisions for agency and presidential waiver of the section 208 self-dealing prohibition at the urging of the Kennedy White House.[22] However, Congress sharply limited the grounds for granting section 208 waivers.[23] Congress and the Kennedy White House, more importantly, underestimated the reluctance of future presidents to grant waivers to high profile presidential appointees and nominees. Waivers are not guaranteed to end public criticism of an official who holds on to stock after obtaining a waiver.[24]

The 1962 law provides for two statutory waivers. First, if the president or other appointing authority determines that a given financial interest is "not so substantial as to be deemed likely to affect the integrity of the services which government may expect from such officer or employee," a waiver may be granted.[25] Second, the 1962 law permits an agency to publish regulations in the *Federal Register* waiving from section 208's coverage a specific type of financial interest held by the agency's employees if it is determined that the

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[20]. Ibid, p. 16.

[21]. Eric J. Murdock, "Finally, Government Ethics as if People Mattered: Some Thoughts On the Ethics Reform Act of 1989," *George Washington Law Review, v. 58* (February, 1990), p. 506.

[22]. "Congress Amends Conflict-of-Interest Laws," *1962 Congressional Quarterly Almanac*, p. 386.

[23]. Murdock, p. 509.

[24]. W. John Moore, "Hands Off," *National Journal*, July 1, 1989, p. 1681.

[25]. Murdock, p. 509 and 18 U.S.C. 208 (b)(1)(1988 & Supp. IV 1993).

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financial interest is "too remote or too inconsequential to affect the integrity of the Government officers' or employees' services."[26]

Conflict-of-interest experts provide various explanations why the section 208 waiver provisions never became a major tool for resolving the conflict-of-interest problems of federal personnel. One critic places the blame on the Justice Department's Office of Legal Counsel for narrowly construing the grounds for issuing section 208 waivers.[27] Two other commentators point to administrative problems associated with obtaining section 208 waivers. "First," they argue, "waivers may prove time consuming to the federal official because of the need to explain the possible conflict to the appropriate authority."[28] "Second," the argument continues, "the federal official must pay close attention to his financial interests in order to determine whether there may be a conflict between matters on which he or she is working and those interests."[29] "Third," the commentators argue, "if a waiver is not granted, the federal official then must take steps to eliminate the conflict either through disqualification or divestiture of the conflicting financial interests."[30] Section 208 waivers, whatever the reason, have never lived up to expectations.

Ethics Reform: Financial Self-Dealing and the Mandatory Divestiture Rule

The Kennedy White House, early in the administration, concluded that it could no longer rely primarily on criminal conflict-of-interest statutes to protect public trust in the objectivity and impartiality of executive branch employees, including presidential nominees and appointees. It decided to issue a series of executive orders designed to supplement criminal prohibitions with administrative

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[26]. Roberts, *Guide*, p. 20.

[27]. Murdock, p. 509.

[28]. Charles D. Fox and David A. Herpe, "Blind Trusts: Easing The Burdens Of Government Service," *Trusts & Estates*, v. 132 (March 1993), p. 30.

[29]. Ibid.

[30]. Ibid.

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conflict-of-interest rules.[31] The 1961 Dutton memorandum, for instance, stated that employees "may not have direct or indirect financial interests that conflict substantially, or appear to conflict substantially, with their responsibilities and duties as Federal employees."[32] However, the Kennedy White House did not try to force federal agencies to enforce the Dutton self-dealing standard.

It would take the issuance of Executive Order 11222 by President Johnson, in May 1965, for the White House to make clear that it expected agencies to enforce a mandatory divestiture rule in certain situations.[33] The White House, after considerable internal debate, included the financial self-dealing language of the Dutton memorandum in Executive Order 11222.[34] White House officials realized that the language would give federal ethics regulators the authority to direct federal employees and officials not purchase certain types of financial assets or to sell off other assets.[35] Regulations issued by the Civil Service Commission implementing President Johnson's standards-of-conduct Executive Order stated that an executive branch officer or employee may not "have a direct or indirect financial interest that conflicts substantially, or appears to conflict substantially with his Government duties and responsibilities."[36] Federal ethics officials, under the authority granted by the Executive Order, clearly had the "authority to order their officials and employees to divest themselves of specific financial interests if those interests [conflicted or appeared to conflict substantially] with their official duties and responsibilities."[37]

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[31]. Roberts, *Ethics*, pp. 93-110.

[32]. Ibid, p. 117.

[33]. "Prescribing Standards of Ethical Conduct for Government Officers and Employees," Executive Order 11222.

[34]. Roberts, *Ethics*, p. 117.

[35]. Ibid.

[36]. Roberts, *Guide*, p. 21.

[37]. Ibid.

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The mandatory divestiture rule of Executive Order 11222 remained in force until President Bush, on April 12, 1989, issued Executive Order 12674.[38] The new order replaced President Johnson's 1965 standards-of-conduct order and included a new mandatory divestiture rule. Regulations issued by OGE implementing President Bush's executive order, gave federal agencies the authority to prohibit employees from acquiring or holding financial interests that "would cause a reasonable person to question the impartiality and objectivity with which agency programs are administered."[39] The Bush White House had made a conscious decision to remove the "appearance standard" from the administrative self-dealing prohibition.

Equally important, OGE regulations give agency ethics officials authority to order executive branch employees to sell financial assets when these officials determine that the acquisition or holding of a financial interest may require "(1) the employee's disqualification from matters so central or critical to the performance of his official duties that the employee's ability to perform the duties of his position would be materially impaired" or the acquisition or holding of the financial interest may "(2) adversely affect the efficient accomplishment of the agency's mission because another employee cannot be readily assigned to perform work from which the employee would be disqualified by reason of the financial interest."[40]

Besides the Executive Order mandatory divestiture rules, Congress has enacted a number of individual divestiture statutes. Officers and employees of certain federal departments and agencies, consequently, are prohibited by specific statute or regulation from holding certain types of financial interests.[41]

Financial Reporting, Blind Trusts and Watergate

On September 27, 1951, President Truman sent to Congress a

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[38]. Stuart C. Gilman, "Presidential Ethics and the Ethics of the Presidency," *The Annals*, v. 537 (January 1995), p. 73.

[39]. 5 CFR 2635.402 (1995).

[40]. Ibid.

[41]. Roberts, *Guide*, p. 18.

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Message on Ethical Standards in the Executive Branch.[42] The message asked Congress to enact a law requiring "all presidential appointees, elected federal officials, military aides, and certain other federal official earning more than $10,000 a year to file disclosure statements, revealing income and such other income sources as investments in real estate, securities, gifts, and loans."[43] The Truman White House proposed the law in an effort to deal with growing criticism directed at the ethical standards of officials in his administration.[44]

Little happened to the idea of government-wide financial reporting by federal officials until President Johnson issued Executive Order 11222. The order directed the Chairman of the Civil Service Commission (CSC) to establish a confidential financial reporting system for high level federal officials.[45] Subsequently, CSC required thousands of federal employees to file annual confidential disclosure statements with their agency ethics officials. Presidential appointees filed their statements with the CSC.

The fact that federal agencies and departments now had information regarding the financial holdings of their employees and officials meant that they had to do more than simply collect the statements and file them away. Executive Order 11222 required that each agency and department take steps to resolve those financial conflicts of interest which appeared on the disclosure statements. The fact that many federal agencies and departments failed to carry out this duty played a major role in persuading Congress to require public financial disclosure in the aftermath of the Watergate

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[42]. President Harry Truman, Message to Congress, September 21, 1951.

[43]. Roberts, *Ethics*, p. 49.

[44]. For a Republicn view of the ethics record of the Truman Administration see Republican National Committee, *Crook & Crony government: the story of Democrat fraud and graft: documented and indexed* (Washington, D.C., 1952).

[45]. Roberts, *Ethics*, p. 123.

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scandal.[46]

Between the issuance of President Johnson's standards-of-conduct executive order and the Watergate scandal, problems continued to persist regarding how to resolve potential conflict-of-interest problems resulting from presidential nominees entering the federal government with substantial private assets. In December 1968, the Nixon transition team made clear that it wanted to recruit business executives for high-level federal policy-making positions.[47] The Nixon White House personnel operation found this goal much more difficult to accomplish than initially anticipated[48] because they underestimated the unwillingness of individuals to subject themselves to scrutiny by a democratically controlled Senate and the Washington media who put the financial affairs of Nixon nominees under a microscope.[49] In fact, the majority of Nixon nominees experienced little trouble receiving confirmation from the appropriate Senate committee.

Yet, a number of well publicized confirmation battles highlighted serious deficiencies with ethics compliance remedies. The confirmation problems of David Kennedy, President's Nixon's nominee for Secretary of the Treasury, raised serious questions regarding the use of blind trusts to as a remedy for financial conflicts of interest. Kennedy, former chairman of the Board of Continental Illinois Bank, refused to sell his stock in the bank because of the capital gains implications of a forced sale.[50] However, Kennedy agreed to place his bank stock in a blind trust.

Since the Second World War, presidents and presidential

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[46]. Comptroller General of the United States, *Action Needed to Make the Executive Branch Financial Disclosure System Effective, FPCD-27-23*, February 28, 1977.

[47]. "Nixon Talent Bank is Open for Business," *Business Week*, December 26, 1968, pp. 98-99.

[48]. Don Bonafede, "Nixon Personnel Staff Works To Restructure Federal Policies," *National Journal*, v.3 (November 12, 1971), p. 2446. Also see "Nixon headhunters bag few Trophies," *Business Week*, January 27, 1973, p. 20.

[49]. Roberts, *Ethics*, p. 131.

[50]. Ibid, p. 133.

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nominees have made increasing use of blind trusts to shield themselves from criticism that their official actions might increase the value of their financial holdings. For example, in the early 1960s, Robert McNamara placed his financial holdings in a blind trust.[51] Lyndon Johnson, upon assuming the Presidency in late 1963, placed his substantial financial holdings in a blind trust.[52] However, the lack of statutory requirements for the establishment of blind trusts made compliance with the agreements voluntary.[53] This fact angered critics of existing ethical standards who believed the lack of clear blind-trust rules let wealthy individuals entering federal service avoid complying with conflict-of-interest laws and regulations.

The arrangement proposed by David Kennedy, consequently, did not constitute a major departure from past practice. The committee balked at the arrangement. Kennedy subsequently agreed to a series of complex steps to shield him from any control over the trust and to require the trustee, over time, to diversify the assets of the trust.[54] However, Senator Gore of Tennessee objected to this ad hoc arrangement on the grounds that the time had come for Congress to pass statutory blind trust requirements.

During the 1960s and early 1970s, "[t]he typical blind-trust agreement required the nominee to place the offending financial interests in a trust and appoint a trustee to make investment decision regarding the trust corpus. The agreement gave the trustee the authority to make any reasonable investment decision without influence from the nominee. Finally, the trustee agreed not to inform

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[51]. Ibid, p. 122.

[52]. "Johnson's holdings put on ice: in trust for the duration," *Business Week*, December 7, 1963, p. 23.

[53]. The Justice Department typically worked with presidents and presidential appointees in the establishment of blind trusts. If a president or presidential appointee agreed to comply with the provisions of the agreement, the Justice Department agreed not to regard the assets placed in the trust as assets of the president or nominees for purposes of Section 208, the criminal self-dealing statute.

[54]. *Congressional Record*, v.115, p. 1293, January 23, 1969.

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the nominee about the details of investment decisions."[55]

The Nixon nomination of David Packard, founder of Hewlett-Packard Corporation, as Deputy Secretary of Defense resulted in another confrontation over the requirement that nominees to the Department of Defense divest themselves of holdings worth more than $10,000. Packard and his family held stock in Hewlett-Packard valued at some $300 million.[56] A forced sale of the stock would have cost Packard and family members millions of dollars in capital gains taxes. The Armed Services Committee permitted Packard to establish a blind trust to avoid a forced sale.[57] Packard, in an unprecedented step, agreed to donate to charity any increase in value of the trust corpus. The Senate confirmed Packard by a vote of 82 to 17.

Watergate, as is well documented, transformed the ethical landscape Washington. Shortly after his 1976 election victory, President-elect Carter announced he would require his appointees to sign a letter of agreement pledging to abide by set of rigorous ethical guidelines.[58] Much more significantly, the Carter guidelines made divestiture, rather than disqualification, the preferred remedy for financial conflict-of-interest problems of nominees.[59] "The guidelines," however, "recognized blind trusts as appropriate methods of divestiture provided the trustee is 'truly independent,' the assets are either cash or diversified assets, and the trustee is given discretion and direction to sell or buy without discussion with the official."[60]

Most Clinton appointees had little trouble complying with the new guidelines. Burt Lance, President Carter's nominee for Director

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[55]. Roberts, *Ethics*, pp. 132-133.

[56]. G. Calvin Mackenzie, *The Politics of Presidential Appointments*, (New York: Free Press, 1980), p. 100.

[57]. Roberts, *Ethics*, p. 133.

[58]. Bruce Adams and Kathryn Kavanagh-Baran, *Promise and Performance: Carter Builds a New Administration* (Lexington, MA: Lexington Books, 1979. pp. 88-89.

[59]. Ibid, p. 89.

[60]. Ibid.

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of the Office of Management and Budget, faced a nightmare. Lance had agreed, as a condition of confirmation, to establish a blind trust by the end of 1977 and "have his trustee sell his National Bank of Georgia stock."[61] The value of the bank stock dropped so much after he entered into the agreement that a forced sale of the stock would have resulted in a huge loss for Lance and raised questions whether he had the means to repay the loan he had taken from the bank to purchase the stock. To relieve the pressure on Lance, President Carter asked the Senate Committee on Governmental Affairs to modify the agreement.[62] A subsequent investigation of Lance's banking and personal financial practices forced Lance to resign on September 21, 1977.

The Ethics in Government Act of 1978 made major changes in the process of reviewing the financial affairs of presidential nominees for possible conflict-of-interest problems.[63] It led to an explosion in the size of the executive branch ethics program.[64] More importantly, Watergate led to intense scrutiny of the federal ethics program. The Ethics Act required high-level federal officials of the legislative, judicial, and executive branches to file annual public financial disclosure statements.[65] The Ethics Act gave the newly created Office of Government Ethics primary responsibility for reviewing the public financial disclosure statements of presidential nominees subject to Senate confirmation and resolving any financial conflict-of-interest problems which appeared on the statements.[66] After the passage of

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[61]. Ibid, p. 92.

[62]. Ibid. p. 92.

[63]. See Mackenzie, "Transitions"; Also see James D. Carroll and Robert N. Roberts, "If Men Were Angels": Assessing The Ethics In Government Act of 1978," *Policy Studies Journal*, v. 17 (Winter, 1988-89), pp. 439-440.

[64]. Gilman, p. 72.

[65]. Ibid.

[66]. Deanne C. Siemer, "Enforcement of the Federal Ethics Laws As Applied to Executive Branch Personnel" Issues and Options Paper, Prepared For the Working Conference on Ethics in Government (Washington, D.C.: Administrative Conference of

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the Ethics Act, Senate committees would not proceed with confirmation hearings until they received a letter from the Director of OGE certifying that the nominee had resolved all outstanding conflict-of-interest problems.[67]

The Ethics Act established two types of blind trusts. The "qualified blind trust" and the "qualified diversified blind trust."[68] The "qualified blind trust" (QBT) does not automatically exempt federal officials from having to comply with the provisions of section 208 and administrative conflict-of-interest regulations. The "qualified diversified blind trust" (QDT) does provide immediate protection.[69]

The QBT is the simplest and least restrictive of the two types of blind trusts authorized by the Ethics Act.[70] As with the QDT, OGE must review the trust to determine that it complies with strict guide lines for establishing blind trusts. However, the QBT has one major limitation. An asset placed in a QBT "continues to be a financial interest of the person" who established the blind trust "for purpose of 18 U.S.C. 208 until the trustee sells the assets or their value is less than $1,000."[71] Consequently, federal officials who establish QBTs must continue to disqualify themselves from participating in particular matters which might affect their financial interests until the trustee of the blind trust notifies the official of the sale of the problem asset. Unless the trustee obtains a certificate of divestiture from the president or the director of OGE, federal tax law requires the official to pay any capital gains taxes due upon the sale of trust assets.

The QDT, in contrast, immediately protects federal officials from section 208 liability. Federal law does not treat assets placed in a

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the United States, March 1, 1988), pp. 25-26.

[67]. See J. Jackson Walter, "The Ethics in Government Act, Conflict of Interest Laws and Presidential Recruiting," *Public Administration Review*, v. 41 (November-December 1981), pp. 659-665.

[68]. Fox and Herpe, pp. 28-35.

[69]. Ibid, p.34.

[70]. 5 C.F.R. 2634.401(a)(ii) and (iii), 2634.403, and 2634.404 (1995).

[71]. "Qualified Rollover," p. 138.

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QDT as assets of the official for purposes of section 208 or other administrative conflict of interest regulations.[72] The restrictions placed on the establishment of QDTs make them much more difficult to establish. QDTs must have a "widely diversified portfolio" of "readily marketable securities."[73] The initial trust portfolio may not contain "securities of issuers having substantial activities in the official's primary area of responsibility."[74]

In the long run, Ethics Act blind trusts have proved too cumbersome and costly for the majority of presidential nominees looking for ways to resolve financial conflict-of-interest problems. The 1980s saw a sharp decline in the use of blind trusts as the a way to resolve the conflict-of-interest problems of federal officials.[75] By the mid 1980s, recusal became the most frequently used to tool to resolve actual or apparent conflicts of interest.[76] Bush Administration presidential nominees made heavy use of recusal or disqualification agreements to resolve conflict of interest problems.[77]

The demise of the blind trust, as a commonly used method of resolving the conflict-of-interest problems of presidential nominees, raised serious concerns with Washington ethics experts. Many feared that excessive use of disqualification agreements seriously reduced the effectiveness of presidential nominees and other federal officials. They feared that "high-level appointees [had become] so wary of any possible conflicts that could cost them their job that they [went] overboard in disqualifying themselves."[78] How effective could a

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[72]. Ibid.

[73]. Fox and Herpe, p. 31.

[74]. Ibid, p. 32.

[75]. See Margaret Carlson, "Going Blind for the Public Trust: Is the Price Too High?" *Washington Dossier*, 9 (June 1983), pp. 37-42; Arlende J. Hershman, "They Put Their Trust in Blind Trust," *Dun's Business Month*, v. 119 (May 1982), pp. 42-45, 48-49.

[76]. Moore, p. 1679.

[77]. Ibid, p. 1682.

[78]. Ibid, p. 1680.

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presidential appointee be if he or she had to check constantly whether an action or decision might have an impact on a financial interest held by an appointee?

Divestiture and non-Recognition of Gain: "The Stealth Remedy"

The early 1980s saw a growing consensus within federal agencies that section 208 waivers, disqualification by federal officials, and blind trusts did not deal adequately with the hardship experienced by presidential nominees required to comply with conflict-of-interest restrictions.[79] Presidential-appointment-process scholar G. Calvin Mackenzie wrote in 1987:

> In many ways, the costs of this movement to tighten the regulation of public ethics are more apparent than the benefits. Recent changes in ethics laws have diminished the privacy of all public officials and increased the direct financial costs of public service for many of them. That has made public service less attractive and thus had a negative impact on the federal government's ability to recruit talented presidential appointees. In the long run, the continuance of this cannot help but undermine effective governance.[80]

Ronald Reagan promised to bring into government individuals with strong business backgrounds if he won the 1980 presidential election. Reagan believed individuals with strong business backgrounds could make government organizations run much more efficiently.[81] Like previous administrations, the Reagan White House found that it took time painstakingly to go over the financial affairs of possible nominees and the members of their immediate family during the process of selecting these nominees for high-level federal positions.[82] It took long negotiations to work out conflict-of-interest compliance

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[79]. See Mackenzie, "Regulation," p. 98-99.

[80]. Ibid.

[81].. Dick Kirsheten, "Wanted: 275 Reagan Team Players, Empire Builders Need Not Apply," *National Journal*, (December 6, 1980), p. 2077.

[82]. Mackenzie, "Transition," pp. 2-10.

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measures. This experience led the Reagan White House to look for ways to make it easier for presidential appointees to comply with conflict-of-interest restrictions.

The Reagan White House and other government ethics experts began to look closely at amending the *Internal Revenue Code*[83] to permit federal employees to defer capital gains from the sale of assets necessary to comply with conflict-of-interest rules. Like the waiver provisions of the 1960s and the blind trusts of the 1970s, supporters of the deferred-taxation remedy believed it "would go a long way toward making government service less burdensome."[84]

In 1982, the staff of OGE prepared a draft paper entitled *Nontaxable Divestiture of Property*,[85] which proposed to permit high-level federal officials to defer paying taxes on the proceeds of financial assets sold to comply with conflict-of-interest restrictions. A number of factors delayed legislative consideration of the proposal to the end of the decade.

First, the Department of the Treasury, in 1982, notified the Reagan White House that it opposed the proposal.[86] The Treasury Department noted that personal circumstances often forced individuals to sell assets and the tax code did not permit these individuals to defer paying capital gains on the sale. The Treasury Department feared that the availability of the rollover provision might induce some individuals to enter government to take advantage of rollover opportunities. The Treasury Department argued that the twenty-percent capital gains tax did not work an undue hardship on federal

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[83]. Title 26, *United States Code*.

[84]. Robert E. Norton, "Who Wants to Work In Washington," *Fortune*, (August 14, 1989), p. 82.

[85]. Stuart A. Smith, "Deferred Taxation of Gains Realized Upon Divestiture of Property to Avoid Conflicts of Interest: A Proposal," *Federal Bar News & Journal*, v. 36 (March/April 1989), p. 128.

[86]. Ibid, Note 10: Letter from Assistant Treasury Secretary John E. Chapoton to Fred F. Fielding Counsel to the President, (Jan. 7, 1982).

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officials required to divest themselves of specific financial assets.[87] Finally, the Treasury Department criticized the proposal because it only allowed presidential nominees to take advantage of the rollover provision.[88]

Second, ethics problems experienced by a large number of Reagan administration officials made it difficult for the Reagan White House to propose this change in the tax code. The media and administration critics, on a daily basis, chronicled the conflict-of-interest problems experienced by members of the Reagan administration.[89] Despite the continuing debate over the substance of many of the allegations, the Reagan administration faced certain defeat of any proposal to allow presidential appointees to rollover capital gains from the forced divestiture of financial assets.

Government Ethics and the Level Playing Field: The Bush Offense

During the 1988 Presidential campaign, George Bush made clear that he would expect his appointees to maintain the highest standards of conduct. The emphasis the Bush White House placed on ethics reform gave supporters of deferred taxation for conflict-of-interest divestiture a new opportunity to lobby for the new remedy.

Instead of focusing public attention on executive branch ethics problems, the Bush White House focused on establishing uniform ethics rules for all three branches of the federal government. The Bush White House realized that Congress, for decades, had imposed new ethics rules on members of the executive branch but did not apply the same rules to members of Congress, congressional staffs, and employees.[90] If Congress refused to apply to itself the ethics rules that it applied to the executive branch, it should relax the most burdensome executive branch ethics rules. The Bush White House

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[87]. Ibid. It is important to note that the Tax Reform Act of 1987 eliminated the lower tax rate for capital gains. Congress, in 1993, passed legislation significantly raising tax rates on higher income individuals.

[88]. Smith, p. 128.

[89]. See for example, Thomas Riehle, "Scandals, Etc. from A to Z," *National Journal*, v. 16, (January 14, 1984), p. 92-94.

[90]. Gilman, pp. 73-74

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wanted a level ethics playing field.

Shortly after taking office, President Bush announced the establishment the President's Commission on Federal Ethics Law Reform.[91] President Bush established four key principles to guide the work of the Commission. First, "ethical standards for public servants must be exacting enough to ensure that the officials act with the utmost integrity and live up to the public confidence in them." Second, "standards must be fair, they must be objective and consistent with common sense." Third, "the standards must be equitable all across the three branches of the federal government." Fourth, the country "cannot afford to have unreasonably restrictive requirements that discourage able citizens from entering public service."[92]

The final report of the Commission included numerous proposals designed to simplify ethics management and to ensure "that all federal employees abide by similar guidelines."[93] Recommendations dealing specifically with the regulation of financial conflicts of interest included: (1) extension of section 208 of title 18 to the judicial branch and to non-member employees of the legislative branch,[94] (2) giving OGE the authority to grant section 208(b) individual waivers,[95] (3) providing tax relief for persons required to divest assets to avoid conflicts of interest,[96] and (4) allowing agencies to grant

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[91]. On January 25, 1989, President Bush issued Executive Order 12668 creating the eight-member President's Commission on Federal Ethics Law Reform. *Congressional quarterly weekly report*, v. 47 (January 28, 1989), p. 199.

[92]. President's Commission on Federal Ethics Law Reform, *Fact Sheet, To Serve With Honor: Report of the President's Commission of Federal Ethics Law Reform*, (March 10, 1989).

[93]. "Bush Special Ethics Panel Releases Proposals," *Congressional quarterly weekly report*, v. 47 (March 11, 1989), p.
523.

[94]. President's Commission On Federal Ethics Law Reform, *To Serve With Honor*, (March 9, 1989), Recommendation No. 2.

[95]. Ibid, Recommendation 3.

[96]. Ibid, Recommendation 4.

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special section 208(b) waivers to advisory committee members.[97] Press reports discussing the recommendations of the panel did not mention the deferred taxation proposal.[98] They did mention proposals to strengthen ethics rules for Congress.[99] On April 12, 1989, President Bush sent legislation to Congress to "toughen some federal ethics standards, loosen some others, make the laws more uniform across the three branches and give federal judges a 25 percent pay raise."[100] The legislation included provisions permitting (1) the tax deferral of proceeds from divestitures required to comply with conflict-of-interest rules and (2) expanded authority to grant section 208 waivers to members of federal advisory committees.[101]

In a speech to the American Society of Newspaper Editors Convention announcing his ethics in government proposals, President Bush stressed that "the same standard that applies to a staff person at HUD should also apply to housing subcommittee staff on Capitol Hill. And a practice is either ethical or it is not. And if Washington is to be a level playing field, then every player should be treated the same."[102]

The Bush White House could not have picked a better time to criticize the ethical climate of Congress. On June 6, 1989, Speaker of the House Jim Wright had announced his resignation. Wright resigned amid allegations that he had received improper gifts from a

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[97]. Ibid, Recommendation 5.

[98]. See "Ethics Panel to Push Bush to Act on Own," *Washington Times*, (March 13, 1989), p. A3; "Ethics in Washington," *St. Louis Post-Dispatch*, (March 21, 1989), p. B2.

[99]. David Lauter, "Tighter Ethics Rules for Congress Urged," *Los Angeles Times*, (March 11, 1989), I2.

[100]. David S. Cloud, "Bush's Package on Ethics, Pay Seeks Uniform Standards," *Congressional quarterly weekly report*, v. 47 (April 15, 1989), p. 817.

[101]. Ibid.

[102]. President George Bush, "Remarks by the President To American Society of Newspaper Editors," The White House, Office of Press Secretary, April 12, 1989.

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Texas developer.[103] A week earlier, House Majority Whip Tony Coelho had announced his intention to resign after revealing he had failed to report a $50,000 loan used to buy junk bonds.[104]

Equally significant, during 1989, the national good government watchdog organization Common Cause directed its lobbying activities to persuading Congress to clean up its act.[105] Common Cause lobbied Congress to prohibit members from accepting honoraria from private sources, to place limits on campaign spending, to provide low cost mail, television, and public financing of elections, and to stop political parties from collecting soft money.[106]

In June 1988, the prospects for congressional approval of the deferred taxation proposal increased when the Administrative Conference of the United States, established by Congress to study and make recommendations concerning administrative procedure,[107] issued "Recommendation 88-4. Deferred Taxation for Conflict-of-Interest Divestitures."[108]

The Administrative Conference recommended that Congress amend the *Internal Revenue Code* "to permit deferred taxation of gains for presidential appointees subject to Senate confirmation and other individuals entering the government to accept high level executive branch positions, whenever they are requested or ordered by an appropriate authority to divest themselves of property to avoid

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[103]. Janet Hook, "Passion, Defiance, Tears: Jim Wright Bows Out," *Congressional quarterly weekly report*, v. 47 (June 3, 1989), p. 1289.

[104]. Ibid.

[105]. Chuck Alston, "Common Cause: A Watchdog That Barks at Its Friends," *Congressional quarterly weekly review*, v. 47 (August 26, 1989), p. 2204.

[106]. Ibid, p. 2207.

[107]. 5 U.S.C. 571-576 (Supp. IV 1993).

[108]. Administrative Conference of the United States, *Deferred Taxation for Conflict-of-Interest Divestiture* (Washington, D.C.: Administrative Conference of the United States. 53 FR 26025, 26029. Recommendation 88-4.); Also see Stuart A. Smith, *Deferred Taxation of Gains Realized Upon Divestiture of Property to Avoid Conflicts of Interest: report to the Administrative Conference of the United States* (Washington: Administrative Conference, 1988).

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actual or potential conflicts of interests."[109]

Under the recommendation, title 26 would permit presidential appointees and the spouses and dependent children of appointees to reinvest the proceeds of divested property into neutral investment vehicles and "thereby defer realization of taxable gains."[110]

The support of the Administrative Conference proved vital to the subsequent passage of the deferred-taxation provision of the Ethics Reform Act of 1989. Critics could no longer attack the measure as a partisan Republican attempt to make it easier to recruit their wealthy supporters for high profile positions.[111] In March 1988, a few months before the Administrative Conference released its proposal, presidential-transition scholar G. Calvin Mackenzie warmly endorsed the deferred taxation remedy in a paper prepared for the Working Conference on Ethics in Government. Quoting from the paper:

> In every future transition, it is inevitable that some appointees will have to divest assets in order to avoidconflicts of interest. The burden of that was magnifiedin 1980-81 by the heavy capital gains taxes that some appointees incurred when they were forced to sell appreciated assets. That burden should be diminished by allowing those assets to be rolled over, without tax liability, into some investment vehicle that poses no potential conflict of interest.[112]

The 1989 Act and the Deferral of Gain from Forced Divestitures

Passage of the Ethics Reform Act of 1989 represented a major victory for the Bush White House.[113] Media coverage focused almost exclusively on the fact that the law prohibited members of Congress from accepting honoraria and that the act granted large pay

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[109]. 53 FR 26025, 26029 (1988).

[110]. 53 FR 26030 (1988).

[111]. See Marshall J. Breger, "Can corporate masters afford to become public servants," *Business and Society Review*, n. 71 (Fall 1989), p. 42-6.

[112]. Mackenzie, "Transitions," p. 19.

[113]. Pub. L. No. 101-194 section 502, 103 Stat. 1716, 1754 (1989).

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raises to members of Congress and high-level officials in the three branches of government. Enactment of the non recognition-of-gain provision received practically no coverage. The non recognition provision of the Ethics Reform Act turned out to be much broader than that of the draft proposal prepared by OGE in 1982. First, the Ethics Reform Act permits any executive branch employee to apply to the Director of OGE for a certificate of divestiture (CD).[114] Second, the Ethics Reform Act permits spouses and minor dependent children of a executive branch employee to apply for a CD.[115] The 1990 amendments to the Ethics Reform Act, equally important, authorized trustees of OGE approved blind trusts to apply for CDs.

Third, the Ethics Reform Act gave the president and director of the OGE considerable discretion to grant or deny a request for a CD. The law permits the issuance of a CD upon a finding that "divestiture of specific property is reasonably necessary to comply with any federal conflict-of-interest statute, regulation, rule or executive order (including section 208 of title 18, *United States Code*), or requested by a congressional committee as a condition of confirmation."[116]

Fourth, the act permits those who receive a CD to rollover the proceeds of the sale, including any capital gainss into "permitted property."[117] The statute defines "permitted property" as any obligation of the United States or any diversified investment fund approved by OGE. This definition means that recipients of CDs have a large number of investment options. More than 3,000 diversified mutual

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[114]. The Ethics Reform Act permitted "special government employees" as well as regular executive branch employees to apply for a certificate of divestiture. The 1962 Conflict-of-Interest Act created a class of federal employees classified as special government employees. These employees serve as federal employees less than 60 days a year. Several federal conflict-of-interest statutes exempt special government from their provisions. See for example 18 U.S.C. 203 and 205.

[115]. 26 U.S.C. 1043 (Supp. IV 1993).

[116]. 26 U.S.C. 1043(b)(2)(B) (Supp. IV 1993); Also see "New Conflict-of-Interest Nonrecognition Provision Creates Planning Opportunities," *Tax Management Memorandum*, v. 31 (February 26, 1990), p. 65.

[117]. Section 1043(b)(3) (Supp. IV 1993). Permitted Property.

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funds operate in the United States.[118]

Fifth, section 1043 permits the rollovers of capital gains to continue "until the sale of the replacement assets."[119] This provision, according to one commentator, permits recipients of CDs to hold on to replacement assets until death. The *Internal Revenue Code* permits heirs of official "to step up the replacement assets to their market value at death."[120]

Applying for a Certificate of Divestiture

The Office of Government Ethics has issued easy to understand rules to guide federal employees and officials wishing to apply for a CD.[121] The application process begins with the employee or official contacting the employees' "designated agency ethics official" (DAEO)-.[122] If the DAEO determines the employee is eligible to receive a CD, the DAEO files a formal request with the director of OGE. The director then conducts an independent review to determine whether the DAEO correctly applied the statutory requirements for issuing a CD.[123] If the director grants the request, the employee receives a document from OGE stating OGE has granted the employee a CD. The employee submits the form with his or her taxes in order to rollover any capital gains resulting from an involuntary divestiture.

It is important to stress, that the Ethics Reform Act only permits OGE to issue a CD for involuntary divestiture. An individual entering the federal government may have other reasons for wanting

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[118]. Janet Novack, "Easing the way," *Forbes*, v. 151(8) (April 12, 1993), p. 42.

[119]. Ibid.

[120]. Ibid.

[121]. Subpart J. Certificates of Divestiture, 5 CFR 2634.1001 Nonrecognition for sales to comply with conflict of interest requirements; general considerations.

[122]. 5 CFR 2634.1002 (1995) Issuance of Certificates of Divestiture.

[123]. According to information provided by the White House, President Clinton has not issued any certificates of divestiture.
The authors have been unable to obtain information whether or not President Bush personally issued any certificates of divestiture during 1990, 1991, and 1992.

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to divest financial holdings. These types of divestiture do not qualify for a CD.

Certificates of Divestiture: The First Four Years:

The years from 1990 through 1993 saw the director of OGE issue 461 CDs. These went to federal employees, spouses of federal employees, dependent children of federal employees and trustees responsible for managing blind trust set up on behalf of federal employees. Three hundred fifty-three family units received 461 CDs.[124] Eleven trustees, over the same period, received Cds. The Director of OGE issued 259 CDs for the years 1990, 1991, and 1992.[125] The director of OGE issued 202 CDs in 1993.[126] Experts expected a significant increase in the number of CDs issued the year after the election of a new president. They proved correct in this judgement.

At least 145 family units of presidential nominees and other political appointees received 225 CDs during 1990, 1991, 1992 and 1993.[127] The Bush Administration, for the years 1990, 1991 and 1992, saw 55 family units of presidential nominees and political appointees received 83 Cds. The family units of 48 presidential nominees received 72 Cds. The Clinton Administration, for the year of 1993, saw 90 family units of presidential nominees and political

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[124]. Family units refers to the federal employee or official, the spouse of the employee or official and the minor children of the officer or employee.

[125]. OGE issued 107 CDs in 1990, 86 CDs in 1991, 66 CDs in 1992.

[126]. It is important to remember that 1993 was the beginning the Clinton Administration. The Bush transition took place in 1989 before the certificate of divestiture provision became law.

[127]. The authors were unable to obtain full lists of presidential nominees and other political appointees for the Bush and Clinton administrations. The Clinton White House refused to provide such a list. Similar lists proved unavailable for the Bush White House. Consequently, the authors checked the names of CD recipients received from the Office of Government Ethics with several staff directories which specifically identify presidential nominees and appointees for the years 1990 through 1993. These include the *Federal Executive Directory* (Washington, Carroll Publishing Company, July/June 1994), *Federal Yellow Book* (Washington, Monitor Leaderhsip Directories, 1994), and *Federal Staff Directory* (Mount Vernon, VA: Staff Directories, LTD, 1990, 1991, 1992, 1993, 1994).

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appointees receive 142 Cds. The family units 72 of presidential nominees received 118 CDs. The family units of presidential nominees and other political appointees received at least 49% of CDs issued over the four year period. The family units of presidential appointees received at least 41% of CDs issued over the four years period.

Public Policy, Public Trust and Certificates of Divestiture

The *Washington Post*, on February 10, 1993, published an article entitled "A Deputy Secretary's Complex Task: Treasury's Altman Seeks to Avoid Potential Conflicts of Interests."[128] The reporter noted "Altman and government ethics officials have agreed that he should sell his interest to avoid a potential conflict of interest."[129] The article noted that Robert Rubin, Clinton's economic policy advisor, would go through a similar clearance process. In contrast, Secretary of the Treasury Lloyd Bentsen established a blind trust to resolve his conflict-of-interest problems.[130] The article, interestingly, failed to note that Robert Rubin, who subsequently became Secretary of the Treasury after the resignation of Lloyd Benson, received two certificates of divestiture in late January 1993.[131]

Forbes magazine, two months later, in an article entitled "Easing the way,"[132] reported that a number of high level Clinton administration officials including Robert Rubin, Roger Altman, and White House Chief of Staff Thomas F. McLarty, III had received certificates of divestiture from OGE.[133] The *Forbes* article discussed the fact

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[128]. David S. Hilzenrath, "A Deputy's Secretary's Complex Task," *The Washington Post*, (February 10, 1993), pp. C1 and C10.

[129]. Ibid.

[130]. Ibid.

[131]. Records provided by the Office of Government Ethics indicate that Robert and Judith Rubin received certificate 93-005 on January 25, 1993. Robert Rubin received certificate 93-006 on the same date, January 25, 1993.

[132]. Novack, p. 42.

[133]. Ibid.

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that the earlier *Washington Post* article did not mention that Rubin or Altman had received CDs which permitted them to rollover capital gains from forced divestitures of assets.[134] The article made clear that the Clinton White House had not gone out of its way to publicize the receipt of CDs by members of the administration.

It appears, after decades of searching, that an extremely effective way for resolving the financial conflict-of-interest problems of presidential nominees, political appointees and other federal employees now exists. Hopefully, in future years, the provision will help persuade successful men and women to accept positions as presidential nominees and appointees.

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[134]. Ibid.

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The Theories of Capitalistic Exploitation: An Examination of their Context and Validity

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Theories of capitalist exploitation have long been central to the Left's worldview. The British Socialist Union saw this clearly when it declared that "the starting point of all socialist thought has been the condemnation of capitalist exploitation."[2]

Eugen von Böhm-Bawerk, one of the leading members of the Austrian School of Economics a century ago, wrote as though exploitation theory were a single concept – which in a certain sense it is since all of the variants are inspired by a single impulse. I prefer in my own analysis, however, to identify at least four distinguishable ideas. This article will discuss each of these in turn. The reader will notice that I see little merit in the first three, but that the fourth will cause me to examine at length what I see to be an historic weakness in the classical liberal theory of a free society. The fourth is pointing to problems of considerable importance in the operation of a capitalistic system.

My discussion will seek to go to the heart of the supposed injustices of the market, and will be broader than a discussion of just labor-management relationships. The analysis will lead us into a consideration, as well, of various "bargaining power" and "consumer protection" issues.

Although the exploitation theories play a large role in socialist thought as central to socialists' critique of capitalism, the discussion necessarily centers on capitalism rather than on socialism.

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[1] This paper expands upon the theme first examined by the author in *Socialist Thought* (Washington: University Press of America, 1983).

[2] The statement by the British Socialist Union is quoted by Norman Thomas in his *Socialism Re-examined* (New York: W. W. Norton & Company, Inc., 1963), p. 27.

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The Labor Theory of Value

The early economists Adam Smith and David Ricardo, both ardently pro-capitalist, devoted considerable attention to the question of "value," trying to come to grips with the underlying principle that can explain the ratios at which goods exchange for one another. Each of them sought the answer in the amount of labor that had gone into the manufacture of the respective commodities. This use of the Labor Theory of Value was more restricted in Smith's thinking than in Ricardo's, however, since Smith applied it only to primitive economies.[3]

Economists of the neoclassical Austrian School later formulated the "subjective" or "marginal utility" theory of value, which they felt better describes the actual choices made in a market.

Socialist thinkers such as Rodbertus and Marx, however, found that the Labor Theory of Value fit well into their conceptual scheme. Their application of the theory contained two parts: First, they continued to define "value" as being the amount of work that went into something. Then, second, they added an extremely significant qualitative judgment: that all of the return should by rights go back to those who had performed the work, since these were the persons who had "created the value." When the capitalist entrepreneur paid the workers a pre-arranged amount contracted for with them as wages and then sold the product of their labor for more, the difference, which he kept as profit, was labelled "surplus value." The socialist authors argued that this constituted a form of exploitation akin to theft. We should notice that it is a point of view that negates the legitimacy of all entrepreneurial profit.

Thus Marx could say in *Capital* that "the rate of surplus-value is therefore an exact expression for the degree of exploitation of labour-power by capital, or of the labourer by the capitalist."[4] *Capital* was, of course, his main economic treatise, and largely consists of an application of the Labor Theory of Value, with its attendant socialist value judgment, to capitalism. "The directing motive," Marx wrote, "the end and aim of capitalist production, is to

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[3] Jacob Oser, *The Evolution of Economic Thought* (New York: Harcourt, Brace & World, Inc., 2nd ed., 1970), p. 82.

[4] Karl Marx, *Capital* (New York: The Modern Library, 1906), pp. 241, 363.

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extract the greatest possible amount of surplus-value, and consequently to exploit labour-power to the greatest possible extent."

Thomas Kirkup has told us about Rodbertus that "the basis of the economic teaching of Rodbertus is the principle laid down by Adam Smith and Ricardo, and insisted on by all the later socialists, that labour is the source and measure of value. In connection with this he developed the position that rent, profit, and wages are all parts of a national income produced by the united organic labour of the workers of the community ...[5]

Maurice Cornforth was an example of the countless socialist authors who have picked up on this theme when he wrote that the "workers are in effect working only in part for their own support and in the main for the support of the exploiters ...

An advocate of a market economy ("capitalism") is immediately struck by the seeming ridiculousness of these arguments. To him, the flaws in applying the Labor Theory of Value in this way are obvious. He will point out that the entrepreneur has added a great deal: he has contributed market foresight, capital risk-taking, organizational skill and a willingness to wait for his own return. The entrepreneur is compensated for all of this through a process of free contractual arrangements, which is a process that is socially desirable in its own right precisely because it permits individual freedom.

If these objections are sound, then how is it that Rodbertus and Marx, who were by no means unintelligent, couldn't see them?

The answer lies in the fact that they implicitly approached the Labor Theory of Value from a different direction than a supporter of a market economy does -- as well as from the direction that they themselves outwardly took. In *Capital*, Marx immersed himself ostensibly in the detail of the market system. From deep within the bowels of the system, he purported to discover the fatal flaw that condemned the wage system and accordingly justified socialism.

But this approach gives a totally false impression. Their theory doesn't stand up when it is perceived in the context of market assumptions. The many criticisms levelled against it by pro-capitalist thinkers make sense. The socialist's qualitative judgment that "the

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[5] Thomas Kirkup, *History of Socialism* (New York: The Macmillan Company, 1909), pp. 125, 141.

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entire return should go back to the worker" can be rationalized only if the thinker *already favors* a fully collectivist economy on *other* grounds. If he assumes the desirability of a collectivist economy, then his assumption prepares him to write off the entrepreneur's role as having no economic or social value, since a planning board, say, would substitute for the entrepreneur in a socialist economy. Because of this, his assumption already rebuts the pro-capitalist's criticism of his theory. There will be no place in his system for either profit or the entrepreneur.

My point is that the socialists' version of the Labor Theory of Value has been presented backwards, in the form of a logical fallacy. It has the conclusion justifying the premises, rather than the other way around. The Labor Theory of Value is not a premise which, by establishing the fatal flaw within capitalism, justifies a conclusion that socialism is preferable; instead, an already-assumed socialist economic model serves as the unspoken premise which, by taking away the function of profit and the entrepreneur, lends the only credence that is possible for the Labor Theory of Value (or, more precisely, for the LTV's value judgment that all return should go to the workers). The so-called premise is entirely dependent upon the conclusion it purports to justify. As an extension of socialist thought, the Marxian version of the Labor Theory of Value is neither more nor less valid than socialism itself, when socialism is evaluated by other considerations.

Class Theory

To the classical liberal advocate of capitalism, the labor market is like all other markets. According to the theory of the "act of exchange," the parties come together in any voluntary contract through inducements that they offer to each other. Each considers his situation improved, or he wouldn't bother to join in. In the labor market, the worker takes the employment which he thinks most attractive in light of his other known alternatives. The terms he receives will result from the interplay of supply and demand. If later he finds that other employers are offering better terms, he will change jobs, provided that it seems to him that doing so will enhance his overall situation.

None of this is accepted by socialist class theory. Class theory postulates that the employers, taken together, constitute a monopoly

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over the sources of employment, so that workers are presented with a lack of meaningful alternatives. The worker must either take what the bourgeois class offers or starve. This is what Kirkup was telling us when he wrote that "the conditions necessary to the existence and growth of capitalism are as follows: – a class, who have a virtual monopoly of the means of production; another class of labourers, who are free, but destitute of the means of production."

The Marxist-Leninist dogmatic type of class theory which claims an inevitable movement of history through dialectical phases is really based on a neo-Hegelian metaphysic. It is not genuinely empirical, despite its pretension to being "scientific socialism." It holds to a schema and won't rest until it finds the categories of that schema in reality. One way we could conclude that it is unsound would be to note that enough time has now passed to show that Marx's predictions haven't proved true in fact. But the essential weakness was apparent from the beginning – and is epistemological. In the absence of building an empirical case it ought to scale down its pretensions from the level of grand "inevitabilities" and settle for making statements, instead, about things that are more amenable to assessment through experience or introspection. Or it ought to offer criteria by which the truth of its assertions can be judged. But it never has; it has just issued broad pronouncements of deterministic inevitability without seeing the necessity of proving them in any way. Even if the predictions came to pass, it would be impossible to say whether this was because the analysis itself was correct or because acting men, spurred by the predictions and wanting to be on (what was once widely seen as) "the winning side," made them self-fulfilling prophecies. This is the main point made so well by Karl Popper in his books *The Poverty of Historicism* and *The Open Society and Its Enemies*.

The empirical case for class theory developed by many of the later democratic socialists is another matter. It calls upon us to look at a given society ourselves to see whether we agree or disagree. And frankly, as we look at modern society in Europe and America, I have to disagree: There is social and economic mobility far beyond anything that has ever existed before. "Classes" exist in the broad sense that we speak of when we refer to the "middle class," etc., but the class theorist's imputation of monolithic, market-defeating classes seems wilfully exaggerated. There are many employers, and these

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offer varied alternatives and are subject to the market forces of supply and demand. People are mobile, moving from job to job and place to place. We even see people change frequently from status to status, being in turn employers, employees and self-employed. In such a society, only those whose vision is colored by alienation and by an overweening concern for those who are assumed to be "entrapped" will see the presence of stultifying classes.

The "Bargaining Power" Theory of Exploitation –
1. As It Applies to Wages

During my lifetime, Americans have been almost unanimous in the view that a free market in labor, in which individuals seek employment on their own, is discolored by an imbalance in "bargaining power" between the worker and the employer. The "bargaining power" theory raises questions that are more difficult than the issues raised by either the Labor Theory of Value or class theory. Its plausibility is created by the fact that, in at least some of its variations, the theory does actually reflect part of the truth.

An interesting and well-written presentation of the bargaining power theory, but which nevertheless failed to go beyond the partial truths that are so popular and which also failed to differentiate between types of bargaining power problems, appeared in Sidney and Beatrice Webb's *Industrial Democracy*.[6]

It is important, I think, to make a distinction that is rarely made. We should distinguish between the concept of "bargaining power" as it applies to wages, where I think it is entirely lacking in merit, and the concept's much sounder application to many other contract terms, both in employment relationships and in other transactions.

The argument that an individual worker "lacks bargaining power" as to wages is an extremely important part of the theory. It is, among other things, the ideological basis for the minimum wage laws within an interventionist system and for the on-going union drive to "raise wages." These are powerful price-fixing forces in the labor market. In turn, they have become major institutional causes of the

[6] Sidney and Beatrice Webb, *Industrial Democracy* (London: Longman's, Green, 1920), pp. 654-55, 673-74, 676-77, 692-93. A convenient excerpt containing the Webbs' discussion may be found in E. Wight Bakke, Clark Kerr and Charles W. Anrod, *Unions, Management and the Public* (New York: Harcourt, Brace & World, 3rd ed., 1967), pp. 290-94.

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unemployment that has, at a certain level, been accepted within an interventionist economy such as the United States since World War II. This then relates to the society's inability to combat inflation through a stabilizing monetary policy; politicians crave "easy money" and free-wheeling government spending to overcome the unemployment that is caused by wages having been set above the supply-and-demand level. The 1970s experience with "stagflation" showed that chronic inflation causes its own dislocations that prevent it from continuing as a panacea for unemployment. This suggests that there are economic realities which the society is not prepared to face squarely. They are problems that are not consistent with the neoclassical economic model that describes how a market economy is supposed to operate.

The bargaining power theory as it relates to wages plays upon a vulnerable psychological point. It focuses on the urgency and weakness an individual feels while he is looking for a job. And even more selectively and effectively, it often focuses on the plight of someone who is looking for work during the downward phase of the business cycle. Since many people live from paycheck to paycheck, they are quite ready to identify with such an individual. They compare his urgency with the needs of the potential employer, which are often less urgent than the job-seeker's. The employer needs workers, but he doesn't necessarily need this particular worker. He may even be able to get along for a time without a new employee at all.

The employer is for this reason considered to be in a "stronger position" from which he can presumably "drive a hard bargain." This suggests that he will be able to pay a lower wage than he would otherwise have to pay.

The trouble with this is that it is one of the *ratio elenchi* fallacies – an argument entirely from sympathy – and ignores the processes that are at work in the market. The fallacy becomes apparent (a) if we think further about the individual's own situation and (b) if we broaden the context to think in terms of overall supply and demand.

Even if a worker accepts a certain wage to obtain a job, his urgency disappears once he is hired. He then begins to hear reports about the wages other employers are paying. If the job he took pays less, he can apply to one of those others.

The advocate of the bargaining power theory will answer that

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"the worker won't actually have those other alternatives in a market based on individual bargaining; all employers will offer the same harsh terms." But this response simply falls back onto the "class theory" of exploitation. It transforms the bargaining power theory into a subset of class theory. A variation of the argument may be that employers will band together to agree on wages, keeping them artificially low. Such a conspiracy is, however, a violation of the classical liberal conception of the competitive market, will be exceedingly difficult for the price (wage)-fixers to maintain, and will be a violation of the anti-trust laws that form part of the legal framework for competition.

If the worker moves, the first employer will suffer the effects of increased employee turnover. The employees who stay with the first firm will tend to be those who cannot command the higher wages that are offered elsewhere. Their job with this firm cannot appropriately be considered "exploitation"; it is a job commensurate with their productivity. It is, for them, an alternative to unemployment. They are being paid the market rate for their level of productivity. The conceptual issue is whether we are to condemn, under the rubric of "exploitation," a firm that decides to operate at lower wages with less efficient workers.

The thinking that underlies minimum wage laws has been that "an enterprise should not be allowed to pay less than the specified minimum; and if outlawing lower-paid jobs results in some workers becoming unemployable, that is a social problem that is the fault of capitalism and that transfer payments should alleviate." This is a line of thinking that reflects alienation and anti-capitalist bias. To those who accept a market economy, it would seem a valid business judgment for a firm to decide to offer employment at less pay to the less productive members of the work force, if that is what will make the firm successful.

Neither has the other worker, the one who changed jobs, been "exploited." There is no reason to judge a real-life process by false expectations that everything will fit perfectly into place right off. The worker who changed jobs has not stayed at the lower-than-market wage. He has just gone through a process of finding his appropriate level.

All of this becomes even clearer if we look at the labor market in a broader "supply-and-demand" context. In a free labor market

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wages will continually tend toward the level at which it is profitable to employ everyone who seeks employment. Only super-ficially is there a bargaining process going on in the dealings among the individuals. The market is almost always highly responsive to larger forces, since monetary remuneration is the foremost item in the competition for workers; it is visible and easy to compare; and it relates to the primary motivation of the worker rather than being merely an auxiliary issue. "Flow," rather than "power," is the essence of it.

This remains true even though firms often don't make their price and wage decisions with conscious reference to supply and demand. If a firm prices its goods on a "cost plus a fair mark-up" basis, for example, this doesn't mean that its prices are independent of supply and demand. A firm can't avoid market forces just by not thinking in terms of them. Its price and wage decisions will still be tested by hard realities such as the speed of inventory turnover, the flow of profits and losses, the rate of employee turnover, and the flow of debt and equity capital toward or away from the business.

One source of "less than market" pay occurs when an employer lets an established employee's pay slip below what he could get if he were to re-enter the available labor pool. Here, the employer is consciously or unconsciously discounting the pay because, with the passage of time, the firm has developed something of a "local monopoly" advantage over the employee. It would require significant inconvenience, expense and trauma for the employee to change to another firm.

It should be noted, however, that this factor can also cut the other way. The higher wage that an employee receives for experience, training and seniority is, on his side, the result of his having become differentiated from the mass of job aspirants in the labor market.

There are two opposing ways that classical liberal supporters of a market economy can view the situation of a worker who is receiving less than market because his roots are in a certain job. One way is to say that "everything in a market is valid if it is based on contract." Another is to say that "the market rate provides a standard by which we can judge that there is an abuse here." I will indicate later here that T feel that classical liberalism would be best served by being more sensitive to market imperfections. It would be wise to consider

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that there is an ethical violation in such a case. It is probable, though, that no classical liberal will cry "exploitation" and seek a legislated solution. Those who support an individualistic society hesitate to call in the state every time they spot a less-than-perfect human relationship. With many such things, they will rely upon an intellectual and ethical consensus.

The "Bargaining Power" Theory of Exploitation –
2. As It Applies to Other Conditions of Employment and to Many Outside the Labor Market

An "inequality (disproportion) of bargaining power" is often sensed in many aspects of employer-employee relationships other than just with regard to wages. In addition, the problem of "bargaining power" appears in countless market transactions outside the labor market.

We are discussing these things as part of an examination of the various anti-capitalist theories of exploitation. At this juncture it is worth stressing that this fourth theory also touches one of the central pillars of classical liberal analysis: the "theory of the transaction" or of "the act of exchange." As a classical liberal myself, I am persuaded that the advocates of capitalism have long done themselves a disservice by making an inadequate examination of the issues that arise out of imperfections in the market. They have clung to too simplistic a model of the market transaction. This has caused classical liberalism to fail to address a number of concerns that people legitimately have in their daily lives. Various societies, including American society, have gone on to address those concerns, but without the intermediation of conscious classical liberal desiderata. Classical liberals' own failure to explore more profoundly their own position has given a very real boost to the socialist criticisms of capitalism. This is one of the effects of classical liberalism's having been forced into a defensive posture for the past century.

Situations regarding conditions of employment. Here are some of the bargaining power situations that pertain to "conditions of employment":

1. Whether there will be a "fair procedure" on such matters as promotion, demotion, transfer, discipline or discharge. When the

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employee hired in, it was virtually impossible for him to hammer out the details of this with his employer. Just the same, an assurance of due process becomes increasingly important to him as he develops a greater "personal investment" in his job over the years.

2. Whether the relationship will be structured adequately to allow the individual to plan dependably for retirement. It is vitally important to an employee that the accumulating pension fund be invested securely and that he is accruing rights that cannot be forfeited by his losing his job, the firm's going out of business, his changing employers, or the like.

3. Whether he is "plugged into" a sufficient system of income-maintenance that will provide sustenance if he becomes disabled.

Jack London launched a devastating attack against capitalism on this score in his novel *The Iron Heel.* London was a great American storyteller, and was also an advocate of revolutionary socialism. He told the story of a worker who lost his arm, and consequently his job and income, in an accident at his machine. London designed the story for maximum effect by describing the worker as having been exceptionally capable. When the worker sought a legal recovery against the company for the accident, several common law defenses barred any tort compensation.

London's story was written in a stridently propagandistic vein, but it raises questions that the theory of capitalism must be prepared to answer to peoples' satisfaction as part of the model of a market economy. Any answer that fails to protect the worker's legitimate interests in such a situation invites disaster both ideologically and politically, and in effect amounts to having a seriously incomplete social philosophy.

4. Whether the employee will be treated in a way that acknowledges his worth as a human being. This is the "dignity of labor" issue.

5. Whether there will be steady employment. Louis Brandeis, one of the leaders in twentieth century American liberalism but quietly an advocate of small-group socialism, saw the lack of continuous employment as one of the critical problems for workers.

6. Whether the work will be diversified and interesting rather than life-deadening in its boredom or strain.

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Situations outside the labor market. Illustrations of "bargaining power" situations outside the labor market include the following:

1. After I completed law school I rented an apartment and had just moved in when the property manager stopped by to tell me that "we like every tenant to sign a written lease." He presented a long form that contained a provision disclaiming liability if I were killed or injured by the landlord's negligence. I saw the attorney for the property management company about it, but he told me that "we aren't willing to negotiate the terms of leases with individual tenants; after all, we have thousands of tenants." I stayed in the apartment for a few months and then moved.

2. Several clients in my law practice have wanted to have homes built for them by local contractors. The sketchy one-page contract that the builder has invariably drawn up has been totally insufficient to protect their interests. I have written out suggested contract terms that would help define specifically what end-product they would be entitled to receive for the many thousands of dollars they were agreeing to pay, and that would protect them from mechanics liens. So far, none of the builders has been willing to discuss such terms seriously. My clients report that "the builder says that we'll just have to trust him if we're going to have him build a home for us." Much of the time, my clients choose to have the home built despite this response. It's worth mentioning that I have seen more people lose their life savings in dealings with home contractors than in anything else.

3. When someone goes to a car dealer to buy a car and strikes up a deal with the salesman, the salesman will usually hand him a bill of sale containing a page or two of printed provisions. The salesman will mark a pencilled "X" at the beginning of the signature line and say, "Just sign here." The customer, who so far has enjoyed an affable relationship with the salesman, will need to change suddenly into an ungracious paranoid if he is to take time to read, much less think about, all of the printed provisions. He just signs. We have hopefully all been raised from infancy to be polite. The effect of this civility upon our ability to guard our own interests can, however, be disastrous.

4. The owner of a medium-sized shopping center can ordinarily impose his own lease terms when he is dealing with small business tenants, who need the center more than he needs any one of them.

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But the owner is in an entirely different situation when he is negotiating with a large department store or other "Triple A" tenant, which most centers desperately need as an anchor tenant to be the main attraction for customers. Then it is the tenant who supplies the lease form and can pretty well say "take it or leave it."

5. Most people are unusually helpful to everyone else during a blizzard, causing everybody to reflect upon "the good side of human nature." A man who runs around with a jeep pulling cars out of snowdrifts for an ample charge is even performing a much-needed service. But what are we to think of the person who, coming upon a woman whose car is stuck along an isolated road, charges her "an outrageous amount" for his help? In light of the fact that classical liberal theory has not traditionally embraced the concept of the "fair price," is a supporter of capitalism to perceive any problem at all in the charge made to the woman?

6. The builder of a home may give the buyers a ten-year warranty under a national warranty program. The buyers believe they are receiving something quite meaningful. They don't really know that, though, unless they read the approved standards carefully – and with an eye experienced in home construction. Speaking generally, warranties are often not really promises that substantially increase the obligations of the warrantor. Warranties are frequently the creatures more of a firm's marketing department than of its legal department. Consumers usually accept the statement that "it's warranted" with a naive conviction that they have been told something meaningful. The result is that they may be receiving mostly "puffing," instead of a well-considered transaction from the point of view of their own interests.

Factors leading to bargaining power disparities. Examples can be cited endlessly. The next step is to isolate the factors that produce the various disparities in "bargaining power." We will leave until later our discussion of the very concept of "bargaining power" and of what solutions, if any, may be offered by someone who favors a market economy. Here are at least some of the factors:

1. *Comparative size.* In some of the situations, an individual or small unit was dealing with a larger organization. Most people assume that a difference in size by itself creates a disparity in

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bargaining power. To a point, they are right, since size may create a psychological advantage. But some of the examples show that major differences in bargaining power can be present even when both parties are approximately the same size. In the example about my clients who have wanted to have homes built, the builders who refused to negotiate an adequately drawn contract usually amounted to one-man businesses themselves. The example of the driver of the jeep also involved a simple person-to-person transaction. Size seems pertinent mainly because it can help supply some of the other factors.

2. "*Local monopoly.*" Being in the right place at the right time is often a major advantage. The jeep driver's fee was exorbitant only partly because the woman urgently needed help; she also lacked other competing sources of assistance. The driver held a temporary monopoly. This factor was even present when the property manager for the apartment I had rented handed me the harsh lease form. By waiting until I had moved in, he had effectively limited my choice of landlords, since moving to any other apartment would then have caused me the serious inconvenience of a second move. In another of the examples, the small businessmen became supplicants in their dealings with the shopping center owner because they knew that only a few centers exist within a given market area. In turn, the center's owner became a supplicant when negotiating with the Triple A tenant, since he knew that there are few such tenants.

In the "condition of employment" situations, there is an element of "local monopoly" that develops over time. The other employers become less and less plausible because only with his past employer does the individual have his seniority, his particularized training, his friends and the satisfaction of being in familiar surroundings. Sometimes a firm deliberately strengthens this hold by establishing a system of forfeitable pension or stock rights which the employee will lose if he changes employers.

3. *Relative urgency.* Countless reasons may cause the parties to approach a transaction with varying degrees of urgency. Because classical liberal theory assumes that such differences are bound to be present in many cases, it accepts the disparity as an unobjectionable part of the act of exchange. We should notice, though, that in the case of the woman whose car was stuck in the snowdrift, her urgency interacted with one of the other factors (the driver's local monopoly) to bring about a substantial imbalance in the resulting transaction.

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4. *Degrees of organization.* A common source of "disparity in bargaining power" occurs when one party is organized and the other is not. If one party has an established *modus operandi* to handle a flow of business, so that both parties implicitly assume that the "expected thing" is to follow that procedure and not "rock the boat" by demanding a different format, that party will normally be able to impose his own structure onto the transaction.

This was the main ingredient in the example of the home builders who would not negotiate ample contracts. They were the ones who were in business, and they had simply "done it a certain way" too long to be hospitable to change for any one home buyer. The urgency of the parties wasn't a factor; in fact, we might suppose that most small builders will be just as (or even more) anxious to find customers as a married couple will be to have a home built by a specific builder. There was no element of local monopoly. And neither was their size important, since both parties were small units in an active market composed of many small units.

A consensus often supports the legitimacy of certain organizational structures. Someone dealing with such a structure will have very little chance to negotiate any changes. I recall watching a football practice where the coaches treated the players in the same abusive way that Marine Corps drill instructors have traditionally treated recruits. It doesn't quite describe the situation to say that the player and the coach are two equal contracting parties, with both taking part only so long as the relationship is mutually beneficial. That is true in an overall sense; but it is not true with regard to any of the specifics. The player "plugs in" contractually to an organization, and any such package deal can carry many specifics with it that are less than ideal.

The various "conditions of employment" are normally arrived at in this way. In a labor market based on individual bargaining, it is only practical that they would be. An employee hires into a firm, which often is much larger than he is. It then establishes all of the incidents of the relationship: what applications to fill out, when he will be paid, the hours he will work, when he will eat lunch, and the like.

5. *Ancillary contract terms.* Many contracts involve a major thrust, which is supplemented by a number of less important ancillary terms. If two equal parties sit down to negotiate a contract without

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urgency, with each being fully advised, they will work out a contract that will express a negotiated meeting of the minds on all of these points. But an enormous number of transactions, inside the labor market and elsewhere, do not occur in this way. The parties come together because they agree on the main aspect, such as when a borrower applies for a loan after asking how much interest the lender will charge. Then the "stronger" party (i.e., the party who has the most favorable position in light of the many factors just discussed) virtually dictates the other terms as an unspoken matter of course. In the case of the loan, the lending institution will produce a set of forms, including mortgages or security agreements with all sorts of small print, which the borrower will accept by acquiescence.

This is again a significant element in "condition of employment" issues. It is actually an amazing fact that the economic relationship that is to be of the longest duration and greatest importance in most peoples' lives – their career with a certain employer – is contracted for loosely and peremptorily, most often on an "at will" basis. Employees usually look at the main thrust, which is the type of work and the amount of pay (and, more often today, the major "fringe benefits"). The countless incidental features are relevant to the job's overall acceptability; but these aspects are established by the organization, not through contractual negotiations. What is more, the many incidents of employment are fluid, necessarily undergoing change as the years go by. As the employee develops deeper and deeper roots in his career, his decreased mobility makes him less able to pass in a meaningful way even upon their overall merit. Still further, it is worth noticing that a work situation that is good in general may not be free of abuses in all of its aspects. A career employee in effect buys a package of indeterminate content, taking a major portion of it on faith.

6. *Lack of auxiliary institutions.* The parties to a carefully drawn contract on a serious matter will satisfy many of their needs by having the contract "plug into" certain already-existing institutions. In a "buy-and-sell agreement" in either a partnership or a closely held corporation, for example, there is a problem of how the surviving investors are to have sufficient liquid funds to buy out the interest of an investor who dies. A common solution is to buy life insurance on each investor's life, so that the proceeds can be the source of payment. The fact that the insurance industry exists is, of course, an

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assumed precondition for being able to do that.

If we think back to the worker in Jack London's story who lost his arm, we can identify a major institutional void as perhaps the core of the problem. At that time more than a century ago, the "Friendly Societies" that had been favored by the French classical liberal economist Frederic Bastiat as a way that workers could provide mutual assistance to each other had not been formed in most industries; and the insurance industry had not grown to provide disability insurance as a standard part of every job. The worker obtained employment with an eye toward what it paid; the contingency of what would become of him if he became disabled was a fearsome incidental that wasn't addressed by the employment contract. In part this was due to a lack of auxiliary institutions. It was also the result of a lack of affluence, in the sense that humanity can think about meeting such contingency needs, no matter how vital, only after it has reached a certain level of affluence.

This is something that should be kept in perspective. By its highly motivated development and application of modern science and technology, capitalism has taken enormous strides to overcome precisely the lack of affluence and the institutional voids that in the past have condemned most people to a severe life. I agree with the fourth theory of "exploitation" in its sensitivity about bargaining power issues, but I thoroughly believe that the Left's alienation has been misdirected.

7. *Competitive "common denominator."* Where firms are competing for customers, competitive pressure will tend to prevent any firm from undertaking expenses which are not also incurred by its competitors, unless the expense justifies itself by differentiating the firm's product enough to attract extra business or allow an increased price. With regard to many incidental features in a transaction, pressure therefore exists toward a relatively inexpensive, low-quality "common denominator."

This is not in itself objectionable. Cheap goods for the many rather than expensive custom-made goods for the rich are a hallmark of the democracy that is implicit in mass-production. There are, however, two sources of difficulty. First, there may be problems as to what Milton Friedman has called "neighborhood effects." It may be that no airline can afford, for example, to retool its aircraft to cut down the noise of their engines unless all competitors are required to

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bear a similar expense; but a noisy "common denominator" may be undesirable in a society in which large air terminals are located in populated areas. Second, a pressure toward shortcuts may result in serious deficiencies in contracts where (for one or more of the reasons already mentioned) the various incidents aren't given two-sided attention by the parties. In an employment contract a worker will have to take the "incidental" feature of job-safety on faith, presuming that the employer will do everything reasonable to keep the job safe. But if safety devices are among the costly items that competition pushes to a low common denominator, his faith may prove ill-founded.

8. *Other factors.* Many additional factors contribute to a bargain's being struck without the parties giving considered attention to all of its implications and to how the vital interests of each party may be served. The fact that there are books about "How to Negotiate" and "How to Win by Intimidation" suggests that the wiles of negotiation play a role. One party may lack self-assertiveness while the other is aggressive. One may lack experience. Both may be influenced by habit and custom. One may be inhibited by a desire to be courteous or trusting, or by a sense of loyalty to an organization that makes him lose sight of the need to look out for himself the way he would in an arm's length transaction. The list could perhaps be endless.

Bargaining power as a concept. Now that we have surveyed the bargaining power issue denotatively, looking first at a series of situations in which it arises and then at the separate factors that introduce a disparity between contracting parties, we are prepared to discuss the underlying conceptual question of whether the notion of "bargaining *power*" even has a legitimate place in social theory. So far, I have deliberately passed over this question, wanting to establish an adequate setting before discussing it. It is a question, by the way, that most people will discount as ridiculously academic, since the average person "knows" (without so much as five minutes' reflection, true; but with the reality-bound non-reductionism that makes "everyday commonsense" a good competitor with most other theory) that the concept is sound. Nevertheless, the classical liberal theory of the market is compelled to take the question seriously, since the "bargaining power" concept is at odds with its traditional

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understanding of market transactions.

The defender of capitalism has characteristically said that "power has nothing to do with voluntary acts of exchange in the marketplace." He has urged, consistently with the marginal utility theory of value, that "such a transaction reflects the difference in subjective evaluations by the parties. One party pays a quarter for an apple, or a million dollars for an apartment building, because to him the apple or the apartment building is worth more than the money he is paying. The other makes the opposite assessment, that to him the money is worth more. In every voluntary exchange, both parties benefit, at least from their own point of view. Neither would be motivated to enter into the transaction if he didn't feel that it would benefit him. This will be true regardless of the urgency of the parties; unless each perceives an overall benefit, the bargain will never be struck. Nor does *power* have anything to do with it. As supporters of a free society, we prefer to speak of *power* only in situations that involve coercion or force, since we don't want to adopt a semantic that obscures the essential distinction between voluntary relationships and those that are foisted onto someone at the expense of his own perceived interests."

This is the creed I have embraced in my own writings, which are classical liberal. I still believe it is sound; more sound, anyway, than the creeds that don't affirm the voluntary transaction as the centerpiece of their social model. Just the same, I have come to believe that classical liberalism has been seriously deficient in its formulation of the theory of capitalism by having been so exclusively preoccupied with the arguments I have just recited.

The trouble with these arguments isn't that they are false, but that they take too static and simplistic a view of market transactions. Everything the arguments assert is correct; but they aren't enough. They fail to consider that a party can enter into an act of exchange precisely because he perceives that it will benefit him, only to look back later and feel quite legitimately that "I was really taken in that one" or that "I did benefit, but I could have looked after my interests a good deal better if the situation had been structured more adequately."

It isn't enough to respond, as a classical liberal will be inclined to do, that "this simply underscores the moral imperative of the individual in a free society to be knowledgeable and capable, and to

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look after his own interests; we cannot, consistently with our overall values, allow ourselves to adopt a paternalistic oversight of market transactions to safeguard his interests for him." No doubt there is considerable classical liberal wisdom in such a response, and the essential point it makes should be kept in mind; but it overlooks the important fact that a transaction does not occur in a vacuum. Even the simplest transaction presupposes the extensive legal, ethical and institutional framework that has grown up as part of the fabric of civilization. There are implied warranties, for example; there are remedies and grounds for possible rescission; there are ethical expectations about "being a man of his word"; and so forth. Classical liberalism's theory of the market has ordinarily assumed these aspects as a given rather than as important subjects for analysis. The real question is whether, *precisely from the point of view of an adequate theory of the market economy,* this legal, ethical and institutional framework has become sufficiently developed and subtle as to facilitate the making of well-considered exchanges. Jack London's story about the worker who lost his arm shows what a telling criticism a socialist can make of capitalism if part of the essential framework is missing.

A concern about these "framework" issues does not mean that a thinker necessarily wants to "substitute his judgment" for the decisions of the parties in a given transaction. A supporter of capitalism will want to set the stage so that millions of people can pursue their *own* ends. He doesn't want to tell them where to go or even how to get there. But his theory of a voluntary nexus is incomplete if he assumes, usually quite implicitly, that there are no legal, ethical or institutional issues relating to the prerequisites for the most workable functioning of such a nexus.

My own view is that classical liberals can well afford to be sensitive to the various "bargaining power" concerns without violating their overall philosophy. Such a suggestion is in some ways earth-shaking, since it invites classical liberal theory, in effect, to "enter the twentieth century" (or perhaps it would be most appropriate to say the twenty-first, since this discussion is being republished in 1996). Classical liberalism can have much more to say than it has in the past about many of the standard "social issues" that have been addressed, largely without classical liberal guidance, during the twentieth century. (It is possible that the "pragmatism" of so many of our political and

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business leaders is in part an adaptation to a felt inadequacy of classical liberal theory.) Its voice can now express a refreshingly different approach, however: one that is aware, even though quite belatedly, of the validity of the issues, but which seeks solutions that are consistent with a voluntaristic system.

Solutions consistent with the theory of a free society. What are the solutions that are consistent with the capitalist ethos with regard to the bargaining power issues? The answer lies in strengthening the framework in the legal, ethical and institutional areas.

1. *The legal framework.* The courts have long recognized that contracts may be rendered voidable by the taint of fraud, innocent misrepresentation, duress and undue influence. When an equity remedy has been sought, the petitioner has had to satisfy the court that he has himself done equity, since all equity remedies are discretionary; and this has permitted courts to refuse certain forms of relief where serious disparities have existed between the parties. In recent years the Uniform Commercial Code has declared that no "unconscionable" provision or settlement will be enforceable. Although the Code's declaration applies only to a "sale of goods," many other statutes and court decisions have followed suit in other areas. There has also been growing reliance on the "contract of adhesion" doctrine which refuses to apply harsh contract terms that are buried within a form that one party has prepared and presented to the other party on a "take it or leave it" basis. All of these developments in the law of contracts and sales relate to the legal framework within which transactions occur. They make the courts, as the enforcing agency, a more active participant in precisely the many bargaining power situations, at least where the abuse is palpable.

Many of these rules are broad rather than specific, and this isn't altogether desirable in light of the Rule of Law criteria that classical liberalism supports. As situations are identified in terms of their more specific components, it should be possible to form more specific rules for many things. And then it may sometimes be desirable to permit the contracting parties to agree to a variation, if they do so knowingly. Some recent "consumer protection acts," for example, prohibit a contract term that eliminates the implied warranties of quality that a seller would normally give. But the same statutes go on

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to provide that the parties may, by specific agreement, bargain about known defects, lowering the price and removing those defects from the warranty coverage. A corporation code is involved in a similar process when it provides that shareholders will not have a "preemptive right" *unless* the Articles of Incorporation establish such a right.

Our law already includes a fair amount of this sort of concern. Even more concern could be built into the law compatibly with the classical liberal rationale for capitalism. The law could curtail many abuses without appreciably interfering with the right of the parties to "make their own transactions." In fact, the resulting contracts could more meaningfully reflect the parties' positions.

Much could be done, for example, through the use of what we might call "paradigm contracts." A statute could spell out the terms of one or more forms of well-balanced home construction contracts, say, and could then provide that the parties are free to deviate from them if the fact of deviation is clearly revealed to both parties. (There may also be points, however, upon which the law would not permit a deviation, since to do so would open the door to some sort of slippery practice that a party could not very well judge.) This philosophy underlies, but finds inadequate expression in, the federal Magnuson-Moss Warranty Act. Under that Act, a manufacturer must label any warranty either "Full" or "Limited." The content of a full warranty is spelled out by the Act, but a manufacturer is allowed complete latitude if he reveals that the warranty is limited. The word "limited" is intended to serve as a warning flag to the public, causing a buyer to inquire into the specifics of the warranty.

Magnuson-Moss could be considered among the statutes that seek to create a flow of all material information to the contracting parties. We see this attempt in the requirement under state and federal securities laws that a public issue of a security must be registered and that each purchaser must be given a copy of a prospectus; in the Truth-in-Lending Act requirement for disclosure statements in connection with most loans; and in the Interstate Land Sales Full Disclosure Act requirement that each buyer of a parcel within an unimproved-land subdivision be given a copy of a detailed "property report."

2. *The institutional framework.* Market processes are often well served by developed institutions, and parts of the "legal framework"

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may help create such structures. The law of corporations is a good example. It creates a type of legal entity that wouldn't otherwise be available. The Employee Retirement Income Security Act of 1974 (ERISA) spells out detailed procedures for pension plans as to the vesting of pension rights, recordkeeping, disclosure, investment of the fund, etc. If we recall my earlier discussion of bargaining power deficiencies relating to "conditions of employment," we come to realize that what ERISA is doing is to fill in the details in a vital part of the career relationship. A similar void with respect to industrial accident and disease was filled by the Workmen's Compensation system.

Those who support capitalism will necessarily want to assert a number of desiderata about how the legal and institutional framework should be strengthened:

(a) Wherever possible, they will want the resulting institutions to be private and competitive, not governmental;

(b) They will prefer that the framework allow optional approaches so that the market can actively germinate new solutions;

(c) They will consider it important to weigh the benefits of any system against its added complexities and costs (something that has been sorely overlooked, for example, in securities regulation, where severe obstacles have been created inhibiting the entry of new businesses into industry, a result that is directly the opposite of the purpose of the antis-trust laws);

(d) Wherever possible, they will prefer a politically decentralized system to one that comes from the federal government; and

(e) They will not accept a legal or institutional intervention on the ground that it is building the framework for the market if they are not persuaded that there is an imperfection in market processes sufficient to call for it.

These desiderata will often give rise to objections to legislation that is not sensitive to them. But the values embodied in these desiderata should not prevent those who are theorizing from a pro-capitalist point of view from seeing the important truth that the free market itself can often be enhanced, even in crucial ways, by a more sophisticated framework.

3. *The ethical framework.* Classical liberal theory has a certain ambivalence about ethics in the marketplace. The theory of a free

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society calls for the attainment of social order through a ubiquitous ethical nexus (noticeably removed from a "do your own thing" concept of freedom), as distinguished from relying on the state to coordinate most human relationships. But then it has been common to define even ethical duty by purely contractual criteria, so that "any exchange is ethical if it is voluntarily entered into without force or fraud."

The points I have raised are, in part, a rebuttal to this latter view. In my opinion a free society needs strong but sympathetic intellectual leadership, and a powerful ethical consensus. I would have each of these give considerably more attention to the subtleties of market transactions. If that happens, many of the problems of bargaining power disparity will disappear, and won't even require legal and institutional changes. Classical liberal theory should throw its weight behind the ancient ethical norm of "do unto others . . . ." It is a good norm for the stronger or better organized party to follow where there is bargaining power disparity.

In this discussion, I have raised points that should be thought-provoking to socialists and free market theorists alike. If the analysis is correct, many of the major socialist attacks on capitalism as "exploitive" are unsound. At the same time, we have seen that the classical liberal theory that underlies the free market is inadequate in at least one very important dimension.

This inadequacy has given "exploitation theory" its greatest justification. The imperfection of the labor market and of consumer markets has actually involved a substantial amount of "taking advantage" and of insensitivity to some fundamental human needs.

This only becomes a significant argument for socialism, however, if the weakness cannot be remedied consistently with classical liberalism's overall values. I believe it can be. A stronger, more tenable theory about bargaining power situations will lead to a stronger, more workable market.

The matters discussed in this chapter could just as well be taken up in a discussion of classical liberalism, since they have to do with the basic theory of a market system. I have taken them up in connection with the socialist concept of "exploitation" because they are also vitally important in connection with socialist thought, which is to a large degree founded on its critique of capitalism.

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Illegitimacy and Television

William Beaver
Robert Morris College, Pennsylvania

The disturbing statistics about illegitimacy in the United States have become all too familiar. Out-of-wedlock births have increased by 200 per cent during the past three decades, to the point that 33 per cent of the children born in this country are to single mothers, usually in their late teens or early twenties. Some predict that by the year 2000 the figure will climb to 40 per cent. Even more disturbing is the impact that single parenthood appears to have on children. For example, a child raised by an unmarried mother compared to one raised in an intact family is six times more likely to live in poverty, three times more likely to be expelled from school, twice as likely to drop out of high school, and three times more likely to suffer emotional problems. Another study conducted by the National Center for Juvenile Justice revealed that 56 per cent of the juveniles in correctional facilities came from single parent homes. For intact families the figure was 28 per cent. In short, some of America's most troubling social problems are associated with out-of-wedlock births – regardless of the debate as to the extent to which these are causally dependent on environmental or genetic factors.

Conservative thinkers have been most prominent in focusing the country's attention on illegitimacy, because they consider it to be the most destructive of all social ills. In fact, Charles Murray doubts that American society can survive if the epidemic of out-of wedlock births continues. Murray has also pointed out that illegitimacy is no longer confined to the minority community: currently twenty-two per cent of all white births are to single mothers, and that figure is also rising.[1]

To help combat the problem, two specific governmental solutions have been suggested. Foremost among these is the removal of economic incentives believed to encourage single parenthood, specifically the curbing of welfare payments to unwed mothers. In

[1] Murray, C. (1993), "The Coming White Underclass," *The Wall Street Journal*, October 29, A18

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the Fall of 1995, Congress passed legislation that would have prohibited welfare benefits to unwed mothers if they were not living with a parent, relative, or legal guardian. Whether or not such provisions will ever become law in the U.S. remains to be seen, since President Clinton vetoed the legislation. The other proposed measure involves economic support for married couples with children – largely by way of tax breaks. This way of combatting illegitimacy by encouraging marriage seems far more likely to become law, since neither political party wants to be accused of being anti-family.

However, many who are concerned with the problem of illegitimacy feel that ultimately there is little that government can do to solve the problem. Rather, they believe that only a shift away from a sexually-charged culture that debases the sexual behavior of young people will bring about meaningful change. As former Secretary of Education William Bennett put it, "Political solutions are not ultimately the answer to problems that are at root moral and spiritual."[2] The answer, they claim, is to promote a return to what historian Gertrude Himmelfarb has termed "Victorian virtues." These involve a promotion of a sense of individual responsibility, self-restraint, respectability, and temperant behavior.[3] These are perceived as being values which if internalized will guide the behavior of young people away from early and irresponsible sexual experience and the pregnancies that too often result. But how will this happen? Presumably government initiatives might help to send the message that illegitimacy is socially undesirable, and that strong, intact families are not only socially desirable but positively essential to society. Obviously, parents play an essential important role in the transmission of cultural values, but not the sole role by any means. In today's world other agencies, most notably television, play a significant role in the development of children. Hence parents need help from other segments of society.

Children, Television and Sex

Although much has been made recently of the potentially

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[2] Bennett, W.J. (1995), "What To Do About Children," *Commentary*, March, 23-28

[3] Himmelfarb, G. (1995), *The De-Moralization of Society: From Victorian Virtues to Modern Values* (Knopf, New York)

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degrading effects of movies, rap music, and cyberspace, television would seem to have a far more pervasive impact on children. The typical child in the United States spends about twenty-five hours a week watching television. By the time a person has reached the age of eighteen they will have logged about 19,000 hours in front of the tube – more than any other activity except for sleep. Moreover, with parents spending less time with their children (20 per cent less since 1970), television's role in the socialization process has grown. As television researcher Donald R. Anderson of the University of Massachusetts put it in referring to television, "it fills the social gap once taken by parents, grandparents, schools, and church."[4] It also goes without saying that parents have less time to monitor and supervise what their children watch.

Although the precise psychological impact of television is still open to question, it would be naive to assume that it is not significant. Any activity practiced so persistently as television-watching is likely to have meaningful effects. A 1988 study sponsored by the U.S. Department of Education concluded that children, far from being turned into zombies, learn much from television, both good and bad. In terms of what they learn that is bad, the most researched subject has been violence, and the emerging conclusion is that television, while not creating copycat violence, does play a role in producing aggression in children. For instance researcher Susan Hearold, after reviewing 230 studies on television violence involving more than 100,000 subjects, concluded that viewing antisocial acts is positively associated with antisocial behavior.[5]

Much less research has been conducted about sex on television and its impacts on young people, but it seems reasonable to assume that something is going on for several reasons. First, consider the amount of sexual messages on television. One study found that there were 10.9 sexual behaviors per hour either physical, verbal, or implied. A study just published by Monique Ward of UCLA focused

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[4] Litwin, S. (1989), "Can You Trust TV As a Baby Sitter for Your Kids?," *TV Guide*, July 1, 1989, 20-22

[5] Hearold, S. (1986), "A Synthesis of 1043 Effects of Television on Social Behavior," in, G. Comstock (Ed.), *Public Communication and Behavior* (Academic Press, Orlando, Florida)

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on the shows most popular among children. The study revealed that on average 29 per cent of the interactions on those shows involved some sort of sexual talk.[6] Perhaps it should not be surprising then that more than one-half the sexual situations and use of crude language occurred during the 8 o'clock family hour. Why so much sex during the so called family hour? The most obvious answer is competition. The Fox Network in order to gain a foothold began airing more sexually explicit shows like *Beverly Hills* and *Melrose Place* during the family hour. *Melrose Place*, whose story lines have included voyeurism, bondage, and sadomasochism, in addition to the heavy doses of more normal sexual behaviors. It's little wonder that children's sexual knowledge is far greater than a generation ago.

Once these shows gained rating's points the other networks felt compelled to follow suit. So for example, *Roseanne* was moved into the family hour slot, and even a show like the *Fresh Prince of Bel-Air*, although not displaying overt sexuality, is now heavily laden with sexual innuendo. Of course high sexual content is not limited to prime time. If anything, talk shows, soap operas, and the tabloids are more sexually charged. In fact some critics maintain that these shows are increasingly making prime time look tame. (Approximately one-half the topics on talk shows are of a sexual nature.) So on any given day during the past couple of years kids could have watched Sally Jesse Raphael interview mothers who allow and even encourage their teenage daughters to have sex. Phil Donahue discussing fantasy dates with Penthouse Pets (with the Pets, of course, on stage), or Hard Copy's expose' on *Charlie Sheen's Porno Queens*. Moreover, these shows are often aired at times that working parents are unable to monitor their child's viewing, even if they wanted to.

Coupled with the sheer volume of sexual messages are the psychological effects involved. A great deal of research, including that conducted by Michael S. LaTour and Richard E. Pitts published in the *Journal of Advertising*, indicates that sex, like violence, gets the viewer's attention along with arousing them.[7] Other research

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[6] Impoco, J. and M. Silver (1995), "Sex and Violence on TV," *U.S. News and World Report*, September 11, 62-69

[7] LaTour, M.S. and R.E. Pitts (1990), "Female Nudity, Arousal, and Ad Response," *Journal of Advertising*, No.4, 51-62

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including the classic studies by Albert Bandura have shown that children imitate adults. This is particularly true if the character is attractive and rewarded for their actions. Research also has demonstrated that watching others perform acts tends to lower the viewer's own inhibitions. For instance, Dolf Zillmann conducted an experiment in which male and female undergraduates regularly viewed sexually explicit films. After several weeks of exposure Zillman found that his subjects were more accepting of both premarital and extramarital sexual behavior than before the experiment began.[8]

If TV does have these effects then parents have something to worry about. As one TV critic and mother put it, "Kids know that all the teenagers on their favorite shows Do It – the only question is when." Adding to the problem is that portrayals of sexual intercourse on television usually take place between unmarried persons. A 1991 study by the American Family Association found that for every scene depicting sexual intercourse within marriage, 14 showed sex outside of marriage. Plus the fact that the overwhelming impression that television gives about sex is positive. Seldom are the negative consequences of sex portrayed, usually it's glamorized. Quite the opposite of what actually occurs when a teenager becomes pregnant.

Finally, psychological conditioning is at work on television, particularly in advertising. Typically a product is paired with some sexual stimuli. The viewer then associates their sexual feelings with the product, which the sponsor hopes will induce the viewer to make a purchase. Unfortunately with so many sexual messages on television, it's the sex that gets reinforced. In fact a study conducted by Wayne Alexander and Ben Judd Jr. published in the *Journal of Advertising Research*, found that when advertisements use sexual stimuli, the viewer tends to remember more about the sex than the product itself.[9]

What's to be made of all this? Certainly television is not the

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[8] Zillmann, D. (1989), "Effects of Prolonged Consumption of Pornography," in, D. Zillmann and J. Bryant (Eds.) *Pornography: Research Advances and Policy Considerations* (Erlbaum, Hillsdale, New Jersey)

[9] Alexander, W. and B. Judd (1978), "Do Nudes Enhance Brand Recall?" *Journal of Advertising Research*, February, 47-51

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only factor involved in shaping a young person's sexual values and behavior. Nevertheless, it seems reasonable to assume that television is an important part of the mix when one considers the amount of time young people spend watching television, the volume of sexual messages aired, coupled with the various psychological factors involved. Moreover Christopher Jencks, in his book *Rethinking Social Policy*, argues that TV and illegitimacy must be linked, simply because other factors cannot explain the rising numbers of middle class teen pregnancies.[10] Factors such as welfare payments and lack of job for males that are used to explain teen pregnancies in the inner cities, are not common to the middle class.

Public Reactions

Public concerns about sex on television appear to be increasing. A survey conducted by *MediaWeek* in 1993 revealed that two-thirds of adults found the sexual content of shows offensive.[11] More recently, a *Time*/Yankelovich poll found that 70 per cent of its respondents were disturbed by the amount of sex on TV, and a 1995 *USA Today* survey of 65,142 adults, found that 96 per were concerned about sexual content on television. Somewhat surprisingly, the respondents in this survey said they were more troubled by sex than the violence on television by a 48 to 40 per cent margin.[12] These kinds of numbers suggest that it's more than the Christian Coalition and conservatives who are upset. Indeed if the polls are accurate, it would seem that a majority of the public believes that things have gone too far and wonder what sexual boundary will be crossed next.

It might come as a surprise to many of those surveyed that all four of the major networks have offices of standards, that ostensibly monitor their programs for "taste and content". As one ABC executive stated, "we take full responsibility for our programs and we think we're responding to the heightened sensitivity by editing our

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[10] Jencks, C. (1992), *Rethinking Social Policy* (Basic Books, New York)

[11] Krumplitsch, K. and A. Browner (1993), "Public Enemy No. 1?," *MediaWeek*, November 1, 18-22

[12] Olmstead, D. and G. Anders (1995), "Turned Off: TV Survey," *USA Today Weekend*, June 2-4, 4-6

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programs very carefully." ABC also provides a list of shows with "viewer advisories" that anyone can receive by calling a toll-free number.

Yet judging by the public response whatever the networks have done is not considered to be enough. The message that seems to be emerging is that what's good for television may not be good for society, and that the industry needs to reassess the sexual content of its programs. Something that the industry has been reluctant to do. The obvious reason is that what appears on television is there because various business interests (networks, sponsors etc.) hope to profit from it, and in that regard there is little doubt that sex sells. If ratings are down or a product isn't selling, turning up the sexual quotient is a formula that gets results. And the formula, if anything, seems to becoming more popular. One TV critic after reviewing the network line-ups for the new season concluded that more sex was in the offing, not less.

Some have come to view the situation as so serious that the only government censorship will work. Yet censorship is something that many Americans find discomforting. We value the concept of free speech, and for that reason television has received a great deal of leeway in regard to what it chooses to air. However it now appears that increasing numbers of Americans feel that the power given to television is being abused. Hence the industry needs to do something to alleviate public concerns, and also because reasonable arguments can be made that television contributes to the serious and growing problem of illegitimacy.

Restraint and a Ratings System

Positive action can begin with individual organizations exercising restraint in regard to sexual content, the same value that many believe needs to be instilled in our children. There is some precedent for such actions. For instance, both Sears and Chrysler pulled advertising spots from the NBC show *Nightingales*, in part, because of the show's explicit sexual nature. Networks and individual stations have also refused to run some sexually charged commercials. Fifteen years ago several stations banned a Calvin Klein ad featuring Brooke Shields purring, "Nothing gets between me and my Calvins." In 1990 ABC, NBC, and CBS all rejected an ad for Jovan Musk. Although ABC did show it, once changes were made. Local affiliates have

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refused to air certain network programs. Most recently, some local stations refused to show the initial episode of *NYPD Blue* because of nudity and one crotch-grabbing scene. And in fairness, network censors do require that content be changed or toned down when deemed to be too offensive. For example, the nude sequence in the initial episode of *NYPD Blue* was cut by 15 seconds to make it more palatable. Fox officials found one episode of *Married With Children* so offensive that it was not aired. Nonetheless, restraint on the part of individual organizations, although to be encouraged and applauded, appears to be random in nature, lacking any consistency. Thus for meaningful change to occur, the television industry needs to act collectively, and in this regard there is some good news.

In February of this year, the television industry announced that they would formulate a ratings system for their shows by January 1997. To this point few details have been released about the exact nature of the ratings, other than the system will be more comprehensive than the one used by the motion picture industry. Both the networks and cable companies will rate their own shows. However, an industrywide committee would monitor the ratings periodically to ensure their accuracy.

The decision to develop a ratings system came after intense pressure was applied by certain members of Congress and the White House. Plus the fact that the new telecommunications bill gives the FCC the authority to appoint an advisory committee to formulate a ratings system, if the industry fails to do so. The networks had always resisted a ratings system on the grounds that it amounted to censorship, but more importantly, because they feared a loss of advertising revenue. Specifically, the industry worried that if a show received an "R" rating advertisers would be scared off for fear of public indignation. This could happen particularly in the short-run. But on the other hand, it seems just as likely that shows rated "G" or PG" could be targeted for more advertising dollars.

A ratings system seems long over due when one considers how network standards are established. As mentioned, each network does have a standards review board. Unfortunately no one seems to know what the standards are. Steven Bochco, co-creator of *NYPD Blue*, maintains that the reality is there are no standards. Bochco states, "Broadcast standards are what they eventually let you do, and that

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becomes the new standard."[13] Bochco's comments appear to be right on the money. In the 1950s the word pregnant could not be mentioned on television. Rob and Laura on the *Dick Van Dyke Show* slept in separate beds. In the 1960s Barbara Eden's bellybutton was not shown on *I Dream of Jeannie*. But gradually new sexual boundaries were established by shows like *Hill Street Blues*, *Nightingales*, and *Married With Children*. So that today varying degrees of nudity, passionate embraces, and graphic language, along with the appropriate grunts and groans are commonplace, and apparently represent the current standard. How far this process will go is anybody's guess. Thus it seems obvious that television needs some basis on which to make judgments about sexual content, and a ratings system can certainly play an important role, since ratings must be based on some criteria. Moreover, if sponsors do become sensitive to "R" ratings, this could quell marketplace pressures that drive television executives to include more and more sex in their programming. In this regard, a *MediaWeek* survey of advertisers revealed that 70 per cent said that if a ratings system was implemented, they would pay attention to it.

Perhaps more than any other measure, a rating system will allow parents to make prudent decisions about what their children watch. Presumably ratings will be published in the various television listings, helping parents to determine the appropriateness of a program. Currently about one-half the parents surveyed say they monitor their children's viewing. A ratings system will only encourage more parents to pay attention to programming. Polls also indicate that a rating system will be popular. For example, the *USA Today* survey found that 83 per cent of the respondents now favor a rating system.

Besides a rating's system, the new telecommunications bill requires that beginning in two years (barring lawsuits) each television set sold in the U.S. must be equipped with a v-chip. The chip would send a signal over the airwaves alerting parents about a particular program's level of violence, sex, and profanity. To do so the chip would interpret a code embedded in the videotape.[14]

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[13] Rensin, D. (1993) "Interview: Steven Bochco," *TV Guide*, August 14, 14-19

[14] Zoglin, R. (1996), "Chips Ahoy," *Time*, February 19, 58-61

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Regardless of one's philosophical views about the chip, the technology has some practical limitations when compared to a ratings system. First, since it's not realistic to retrofit existing sets, only new TV's will be equipped with the chip. Taking into account that the average TV now lasts eleven years, it could take a considerable amount of time for the majority of parents to make use of the technology. Secondly, the v-chip wouldn't provide as much information as would a comprehensive ratings system. As currently envisioned, programs would receive a rating of 0 to 5, with 0 being the least objectionable, and 5 the most objectionable in terms of violence and sex. Parents would then set the level of programs they desired. However, such a limited range does not provide parents with specific information on which to make judgments. This could be particularly important when one considers the different age-levels of children within a family. Obviously what is appropriate for a 14 year old may not be for a 7 year old. Finally, in this computer age where children's knowledge of electronic devices is ever increasing, many ingenious kids will discover ways to circumvent or manipulate the technology so that they can watch the shows they want.

Nonetheless, the development of a ratings system and the v-chip should give parents more control in determining what shows their children watch. This may help parents to nurture the values that will guide their children away from early sexual activity, but it needs to become more widely recognized that television has become an integral part in the life of a child, and that the sexual content of programs may be promoting social ills. Increasing levels of restraint, along with ratings and the v-chip should meantime play some role in lessening illegitimacy.

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